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No. _____

In The

Supreme Court of the United States

SIMON ZUNAMON, as Trustee of Washington Trusts Nos. 1-176, and MARSHALL E. EISENBERG, as Trustee of A.N.P. Trusts Nos. 1-42, R. A. Trusts Nos. 1-25, and F.L.P. Trusts Nos. 10-17 and 19-21,

Petitioners,

v.

GLEN L. BOWER, Director of the Illinois Department of Revenue; and THE ILLINOIS DEPARTMENT OF REVENUE,

Respondents.

On Petition For Writ Of Certiorari To The Appellate Court Of The State Of Illinois

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is a state income tax on a resident trust's out-of-state income subject to Commerce Clause scrutiny?

2. Does the Illinois "Replacement Tax" on a resident trust's out-of-state income violate the Due Process and Commerce Clauses because it does not allow a credit for income tax paid to the state where the income was earned?

PARTIES TO THE PROCEEDINGS

Defendant Glen L. Bower is currently the Director of the Illinois Department of Revenue; he has been substituted for former director Kenneth E. Zehnder by operation of law, pursuant to 735 ILCS 5/2-1008(d) (substitution of trustees and public officers). Marshall E. Eisenberg is the current trustee for F.L.P. Trusts Nos. 10-17 and 19-21; he has been substituted for Charles Evans Gerber, the former trustee, pursuant to 735 ILCS 5/2-1008(d). All of the other parties who appeared in the Appellate Court of Illinois are listed in the caption of the case.

Oregon Trusts Nos. 1-208 appeared before the Circuit Court of Cook County, but did not participate in the appeal to the Appellate Court of Illinois.

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PETITION FOR A WRIT OF CERTIORARI

Simon Zunamon, as Trustee of Washington Trusts Nos. 1-176, and Marshall E. Eisenberg, as Trustee of A.N.P. Trusts Nos. 1-42, R. A. Trusts Nos. 1-25, and F.L.P. Trusts Nos. 10-17 and 19-21, petition for a writ of certiorari to review the judgment of the Appellate Court of Illinois entered on September 16, 1999.

OPINIONS BELOW

The Opinion of the Appellate Court of Illinois is reported as *Zunamon v. Zehnder*, 308 Ill. App. 3d 69, 719 N.E.2d 130 (1999), and is reproduced in Appendix A. The April 3, 1998 Memorandum Decision and Order of the Circuit Court of Cook County and the November 18, 1996 Notice of Decision of the Illinois Department of Revenue, Office of Administrative Hearings, are unreported and are reproduced in Appendices B and C, respectively.

JURISDICTION

The order of the Supreme Court of Illinois denying discretionary review of the Appellate Court's decision was issued on February 2, 2000 and is reproduced in Appendix F. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment to the United States Constitution, U.S. Const. amend XIV, § 1, provides that "No state shall . . . deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3, provides that "The Congress shall have Power . . . To regulate commerce with foreign nations, and among the several States, and with the Indian tribes."

Relevant portions of the Illinois Income Tax Act are reproduced in Appendix D.

STATEMENT OF THE CASE

A. RELEVANT FACTS

Petitioners (the "Trusts") are Illinois resident trusts which earned income outside Illinois. The Illinois Income Tax Act, 35 ILCS 5/101 *et seq.*, imposes two separate net income taxes on trusts: a 3 percent income tax and a 1.5 percent "Personal Property Tax Replacement Income Tax" (the "Replacement Tax"). 35 ILCS 5/201(b)(3), (c) & (d), App. D-1, D-2. The "Replacement Tax" received its name because it was enacted in 1979 to replace the revenue from the Illinois *ad valorem* personal property tax which was repealed at the same time. Taxable income is

virtually identical for both taxes, and is calculated as federal taxable income with certain state modifications. 35 ILCS 5/203(c) & (e)(1).

A resident trust is subject to Illinois income and Replacement Tax on all of its income, including out-of-state income. 35 ILCS 5/201, 301(a) & 1501(a)(20), App. D-1, D-3, D-4, D-5. Income taxes paid to other states can be credited against the income tax, but no similar credit is available for the Replacement Tax. 35 ILCS 5/601(b)(3), App. D-4. Nonresident trusts, corporations and other entities are also subject to Replacement Tax, but are taxable only on their income from Illinois sources. 35 ILCS 5/301-308 & 1501(a)(14).

In calculating their Illinois tax liability, the Trusts claimed two credits for income taxes paid to other states on the same income that was taxed by Illinois: an "Income Tax Credit" and a "Replacement Tax Credit." The "Income Tax Credit" was authorized by 35 ILCS 5/601(b)(3). App. A-10; App. D-4.

The Trusts claimed the Replacement Tax Credit against the Replacement Tax to prevent actual double taxation of their non-Illinois income. This credit was calculated in the same manner as the Income Tax Credit, and did not include any credit for any non-Illinois tax already claimed as an Income Tax Credit. App. E-9.

It is undisputed that the income for which the credit was claimed was earned completely outside Illinois, and that each Trust's status as an Illinois resident is the only basis for Illinois to tax that income. None of the income would have been taxable in Illinois if a Trust had been a nonresident of Illinois. App. E-7, ¶ 14. The Trusts were

treated as nonresidents in the other state; the same amount of income would have been sourced there if that state had the same sourcing rules as Illinois. App. E-2 ¶ 3, E-7 ¶ 13.

B. THE PROCEEDINGS BELOW

The Trusts filed original or amended returns with the Illinois Department of Revenue (the "Department") to claim the Income and Replacement Tax Credits for the taxable years in issue. The Department denied both credits, and the Trusts protested that denial. The Department's Office of Administrative Hearings heard the case on cross-motions for partial summary judgment, and granted summary judgment in favor of the Department. App. C-37.

The Department ruled that the Trusts were not entitled to the Income Tax Credit because they had deducted the non-Illinois tax on their federal income tax returns and then added it back to determine their Illinois taxable income. The Department disallowed that addback because it was not authorized by the statute during the years in issue. App. C-9, C-15, C-16. Without the addback, the Income Tax Credit was not available because the Trusts would receive a double benefit (both a deduction and a credit) for the same tax. 35 ILCS 5/203(h) & 601(b)(3), App. D-3, D-4. The Illinois statute was later amended to expressly allow the addback made by the Trusts. 35 ILCS 5/203(c)(2)(F), App. D-3.

The Department denied the Replacement Tax Credit because it was not expressly provided in the Illinois tax statute. App. C-8, C-24. The Trusts argued that the

income and Replacement Tax credits were required to satisfy Due Process and Commerce Clause requirements. The Department rejected these arguments on the grounds that a state can tax all of a resident's income, and that a credit was not constitutionally required. App. C-16-23.

The Trusts appealed the Department's decision to the Illinois state courts. The Cook County Circuit Court upheld the Department and denied both credits. It rejected the Trusts' Due Process and Commerce Clause arguments because it viewed a state's power to tax its residents as being different from a state tax on interstate commerce. App. B-14, B-16-17, B-20-23.

The Illinois Appellate Court approved the Income Tax Credit as a matter of statutory construction and reversed the Circuit Court on this issue. App. A-7-10. However, it upheld the denial of the Replacement Tax Credit, finding that it was not required under the U.S. Constitution. App. A-8-10.

REASONS FOR GRANTING THE WRIT

The Trusts challenge Illinois' power to tax a resident trust's out-of-state income without any credit for income tax paid to the state where the income was earned. The Illinois Replacement Tax violates "internal consistency" and the other Commerce and Due Process Clause requirements for state taxes which have become known as the "*Complete Auto* tests" after *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

The Illinois courts cited the *Complete Auto* tests but refused to apply them under the mistaken theory that they do not apply to "residents." App. A-12-13, B-23. The Circuit Court noted, "It is clear that the Illinois taxing scheme for resident trusts for the taxable years at issue would not pass constitutional muster under *Complete Auto.*" App. B-16. It also recognized that Illinois' failure to provide a credit discriminated against interstate commerce:

> by imposing a second level of state taxation on income earned outside Illinois by trusts without a credit for the tax paid to the source states, *Illinois' taxing scheme benefits Illinois economic interests while burdening economic interests outside Illinois.* Stated differently, the taxing scheme at issue gives a competitive edge to Illinois investment opportunities since Illinois trusts investing in those opportunities would not be subject to the double taxation which would be imposed on income earned from investments outside Illinois.

App. B-16 (emphasis added).

This Court should make it clear that the same constitutional analysis that governs other types of state taxes also governs state income taxes on residents. *Complete Auto* applies to state income taxes on corporations. *E.g., Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425 (1980); *Container Corp. v. Franchise Tax Board,* 463 U.S. 159, 165-66 & 169 (1983). *Complete Auto* also applies to intangibles taxes on residents. *Fulton Corp. v. Faulkner,* 516 U.S. 325 (1996). Therefore, *Complete Auto* applies to state income taxes on residents.

A. THE INTERNAL CONSISTENCY TEST DEMONSTRATES THE CONSTITUTIONAL VIOLATION

This Court has consistently ruled that a state tax must meet four tests:

> (1) There must be a substantial nexus between the activity being taxed and the taxing state;
>
> (2) The tax must be fairly apportioned;
>
> (3) The tax may not discriminate against interstate commerce; and
>
> (4) The tax must be fairly related to the services provided by the state to the taxpayer.

This four-part framework was first expressed in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 287 (1977), as a summary of many prior decisions.

A state tax that violates any of these four tests is invalid under the Commerce Clause. A tax which violates the first two tests also violates the Due Process Clause. *E.g., Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165-66 & 169 (1983) (applying these tests in upholding the worldwide unitary method of calculating state corporate income taxes); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 778 (1992). A tax can violate the Commerce Clause even if it satisfies Due Process requirements. *E.g., Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (mail order company not required to collect use tax).

Fair apportionment, the second *Complete Auto* test, requires a taxing state to reasonably measure the amount of multistate income which is attributable to in-state

sources. This has two aspects: internal and external consistency. Internal consistency requires a tax to be structured so that no more than 100 percent of a taxpayer's income would be taxed if every state imposed a tax which was identical to the one in issue. *Container, supra,* 463 U.S. at 169; *Goldberg v. Sweet,* 488 U.S. 252, 260-62 (1989).

It is undisputed that the Replacement Tax violates internal consistency. If the state where the income was earned had the identical income tax statute as Illinois, the Trusts' out-of-state income would be taxed in two states: the source state would tax it as income from in-state sources pursuant to 35 ILCS 5/301-308 (sourcing rules for income received by nonresidents), while Illinois will tax the same income under 35 ILCS 5/301(a) (resident taxed on all income). App. E-2 ¶ 3, E-7 ¶¶ 13, 14.

Thus, the Trusts are being taxed on 200 percent of their out-of-state income, while no more than 100 percent may be taxed in accordance with the internal consistency test:

> For over a decade now, we have assessed any threat of malapportionment by asking whether the tax is 'internally consistent' and, if so, whether it is 'externally consistent' as well. . . . A failure of internal consistency shows as a matter of law that a State is attempting to tax more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax.

Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995) (citations omitted).

B. INTERSTATE COMMERCE IS IMPLICATED HERE

The Trusts were engaged in interstate commerce when they earned income from another state. This Court has consistently treated economic activity which crosses state lines as interstate commerce. *E.g., Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984); *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 240-41 (1987).

Even purely in-state activities (not the case here) are subject to Commerce Clause analysis if they affect interstate commerce. For example, a local property tax exemption was held invalid in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997), because it discriminated against interstate commerce. "A tax on real estate, *like any other tax*, may impermissibly burden interstate commerce." 520 U.S. at 574 (emphasis added). Thus, the Commerce Clause applies to the Replacement Tax on trusts, just as it applies to "any other tax."

An intangibles tax which discriminated against stock issued by out-of-state corporations was invalid under the Commerce Clause. It was irrelevant that the tax was imposed on resident shareholders and not on the corporation. *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996). *Tamagni v. Tax Appeals Tribunal*, 91 N.Y.2d 530, 695 N.E.2d 1125, *cert. denied*, 520 U.S. 931 (1998), explained *Fulton* as an example of discrimination against an interstate market because the effect of the tax was that stock in domestic corporations was taxed less than stock in out-of-state corporations. "The effect on an interstate market in such a

case is obvious, and is more than incidental." 91 N.Y.2d at 542, 695 N.E.2d at 1132.

If the Illinois decision is allowed to stand, Illinois resident trusts will have a tax motivation to avoid double taxation by investing only in Illinois. Other states will be free to adopt a similar approach under their income taxes on their own residents. They could do so for individuals as well as trusts since both classes of taxpayers are classified as "residents."

If every state taxes all of its residents' income without any credit, residents would be encouraged to invest only in their home state and avoid paying two taxes on their out-of-state income. That type of tax incentive would frustrate free trade among the states, the purpose of the Commerce Clause:

> A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce.

Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 334-35 (1977) (New York stock transfer tax violated the Commerce Clause by imposing a higher tax on sales made through out-of-state stock exchanges).

C. THE *COMPLETE AUTO* FRAMEWORK APPLIES TO ALL STATE INCOME TAXES

The *Complete Auto* tests clearly limit a state's power to tax the income of corporations. Most recently, *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768

(1992), rejected a New Jersey income tax on a non-domiciliary corporation. The *Complete Auto* framework should also apply to state income taxes on trusts and other resident taxpayers.

The Illinois courts completely overlooked the first *Complete Auto* requirement: "in the case of a tax on an activity, there must be a connection to *the activity* itself, rather than a connection only to *the actor* the State seeks to tax." The Court viewed this as a "fundamental requirement of both the Due Process and Commerce Clauses." *Allied-Signal*, 504 U.S. at 777-78 (emphasis added). Here, the "actors" are the Trusts, and the "activity" is their out-of-state income. It is not enough to find that the taxing state has jurisdiction over the taxpayer because

> A State may not tax value earned outside its borders . . . The reason the Commerce Clause includes this limit is self-evident: In a Union of 50 States, to permit each State to tax activities outside its borders would have *drastic consequences for the national economy*, as businesses could be subjected to severe multiple taxation.

504 U.S. at 777-78 (emphasis added).

The Illinois courts mistakenly believed that a state has a special power to tax 100 percent of a resident's income. This conclusion conflicts with *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), where the Court concluded that the Commerce Clause limits the taxing power of a corporation's state of domicile. The same analysis should apply to a state's power to tax its residents.

Mobil held that Vermont could tax certain dividend income even though the taxpayer was domiciled in New York. The corporation argued against the Vermont income tax on the theory that it caused a substantial risk of multiple taxation (unlike the actual double taxation present here). Mobil claimed that New York, its state of incorporation and domicile, had the power to tax all of its dividend income: If New York could tax all of Mobil's dividends, then Vermont should not have been able to tax even a part of them. (In actuality, the dividends were exempt in New York.) 445 U.S. at 444.

This Court rejected Mobil's argument:

> Although we do not now presume to pass on the constitutionality of a hypothetical New York tax, *we may assume, for present purposes, that the State of commercial domicile has the authority to lay some tax on appellant's dividend income as well as on the value of its stock. But there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States.* In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method. Since Vermont seeks to tax income, not ownership, we hold that its interest in taxing a proportionate share of appellant's dividend income is not overridden by any interest of the State of commercial domicile.

Mobil, 445 U.S. at 445-46 (emphasis added).

The state where the income is earned has the first right to tax it. *Mobil, supra. Accord, Japan Line, Ltd. v.*

County of Los Angeles, 441 U.S. 434, 447 (1979) ("The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full"); *Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952) ("The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile").

Japan Line stated that, "In interstate commerce, if the domiciliary State is 'to blame' for exacting an excessive tax, this Court is able to insist upon rationalization of the apportionment." 441 U.S. at 454. Here, Illinois is "to blame" for imposing an excessive tax on the Trusts. There is no apportionment because there is no credit or other mechanism for preventing double taxation. This Court should exercise its power to "insist upon rationalization of the apportionment" and invalidate the Replacement Tax to the extent it does not provide a credit.

D. STATE COURTS HAVE ERRONEOUSLY CREATED A "RESIDENCY EXCEPTION" TO THE COMMERCE CLAUSE

The Illinois courts approved the *Complete Auto* violation in this case because they mistakenly viewed several decisions of this Court as holding that the Commerce Clause does not limit a state's power to tax its own residents.

The Appellate Court misconstrued *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989), when it cited *dictum* in that case for the proposition that the Commerce Clause does not "protect state residents from their own state taxes." App.

A-13-14. In *Goldberg*, this Court applied *Complete Auto* to a telecommunications tax on 100 percent of the charge for an interstate telephone call. The primary reason why the tax was upheld was that it provided a credit: that met the internal consistency test and addressed the Court's concerns about the risk of multiple taxation. *Goldberg v. Sweet*, 488 U.S. at 264-65.

West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994), further refutes the *Goldberg dictum*. That case held that a Massachusetts assessment on milk sold to in-state retailers violated the Commerce Clause because it had the economic impact of a tariff on out-of-state milk producers. The fact that the price increase was paid by in-state consumers, *i.e.*, residents, did not excuse the discrimination against interstate commerce:

> The cost of a tariff is also borne primarily by local consumers, yet a tariff is the paradigmatic Commerce Clause violation.

West Lynn Creamery, 512 U.S. at 203.

The Illinois courts were seriously mistaken when they interpreted three decisions of this Court as providing an exception to *Complete Auto* for state income taxes on residents: *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450, 463 n.12 (1995); *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937); and *Lawrence v. State Tax Commission*, 286 U.S. 276 (1932). App. A-12-13, B-20-23.

Lawrence and *Cohn* held that a state can tax a resident on out-of-state income which has not been taxed in any other state. They were decided only under the Due Process Clause, and have no relevance to the Commerce

Clause. *See Lawrence*, 286 U.S. at 279; *Cohn*, 300 U.S. at 311, 314. Moreover, these two early cases did not involve any actual double taxation because the income was not taxed by the state where it was earned. Thus, even as to the Due Process Clause, this Court has never considered the issue of whether the state of residency is required to provide a credit if the out-of-state income was previously taxed.

Chickasaw held that members of the Chickasaw Tribe who worked on tribal lands but lived in Oklahoma outside tribal territory were subject to Oklahoma income tax. 515 U.S. at 462-63. This was a matter of federal preemption and the proper interpretation of an 1830 treaty between the tribe and the United States. The Commerce and Due Process Clauses were not implicated because an Indian tribe is not a state. There was not even any double taxation: The Court carefully noted that the tribe did not "complain that Oklahoma fails to award a credit against state taxes for taxes paid to the Tribe." *Chickasaw*, 515 U.S. at 464 n.13.

However, *Chickasaw* cited *Cohn* for a "well-established principle of interstate and international taxation – namely, that a jurisdiction, such as Oklahoma, may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Chickasaw*, 515 U.S. at 462-63 (footnote omitted; emphasis in original). The Illinois courts viewed this reference as a confirmation of their view that *Cohn* provides an exception to *Complete Auto* for state income taxes on residents. This use of *Chickasaw* erroneously takes the Court's observations completely out of context.

The Illinois Appellate Court misquoted *Chickasaw* when it stated that "While states commonly credit income taxes paid to other states, 'this is an independent policy decision and not one compelled by jurisdictional considerations.' " App. A-13, quoting 515 U.S. at 463 n.12. The "independent policy decision" to which this Court referred was whether or not a "sovereign" (not a state) decided to grant an exemption (not a credit) for income which its citizens earned abroad. The Court's statement was directed at a country's right to tax the resident of another country under international law. Other than *Cohn*, the authorities addressed by the Court dealt only with federal and international tax law. *See* 515 U.S. at 463 and n.12-13.

The Illinois Circuit Court was similarly mistaken:

> the court concludes that *Complete Auto* has not changed the principle recited in *Lawrence v. State Tax Comm'n* and in *New York ex rel. Cohn v. Graves* that a state may tax all the income of its residents, regardless of whether this same income is taxed by another state and regardless of whether the state of residency allows credit for the taxes paid to another state. That these decisions remain controlling and vital is seen by the fact that the Supreme Court continues to rely on them [citing *Chickasaw*].

App. B-20 (citations omitted).

This erroneous "residency exception" to the Commerce Clause is not limited to Illinois. The highest state courts in New York, Minnesota and Connecticut have made similar errors in applying *Cohn*, *Lawrence* and *Chickasaw* to their income taxes on residents.

Tamagni v. Tax Appeals Tribunal, 91 N.Y.2d 530, 695 N.E.2d 1125, *cert. denied*, 525 U.S. 931 (1998), upheld a New York definition of a resident individual which was internally inconsistent. Under the New York approach, a person can be a "resident" of more than one state, and taxable on his total income in all of them. If that occurred, no credit would be available: New York only provides a credit for income tax paid to the state where it was earned, but it sources investment income to the state of residency.

While Mr. Tamagni was classified as a "resident" of both New York and New Jersey, New Jersey allowed a credit for the New York tax. Thus, there was no actual double taxation of the same income; even if there were, Mr. Tamagni would have had to prove that New Jersey's definition of a "resident" was right, and that New York's was wrong, so that New York would be at fault for the double tax.

However, the New York Court of Appeals did not restrict its opinion to these grounds. It broadly claimed that a state tax on a resident was not limited by the *Complete Auto* tests because "the tax does not fall on any interstate activity, but rather on a purely local occurrence – the taxpayer's status as a resident of New York State." 91 N.Y.2d at 543, 695 N.E.2d at 1133.

> The inapplicability of dormant Commerce Clause analysis to State resident income taxation is further supported by both historical precedent and the fundamental State sovereignty interest at stake. The Supreme Court has long held that multiple taxation of State residents is not forbidden. While this line of cases involved

> due process challenges, the very fact that the dormant Commerce Clause was never mentioned as a limitation on State power to tax resident income suggests that there is no such limitation. Indeed, in *Goldberg v. Sweet*, the Supreme Court stated that '[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes.'

Tamagni, 91 N.Y.2d at 544, 695 N.E.2d at 1134 (citations to *Cohn*, *Goldberg v. Sweet* and other cases omitted).

The Minnesota Supreme Court reached the same result as *Tamagni* in *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn.), *cert. denied*, 120 S.Ct. 66 (1999). There, the taxpayer was treated as a resident of Minnesota even though she was domiciled in Florida. The court rejected her Due Process and Commerce Clause arguments against a Minnesota tax on her entire income:

> Luther attempts to analogize her case to business taxation cases which apply the unitary business rule of apportionment. . . . The concern underlying the unitary business rule of apportionment is the risk of multiple taxation. However, individual taxpayers and corporate taxpayers may constitutionally be treated differently for tax purposes [citing *Lawrence*].

Luther, 588 N.W.2d at 509.

The Connecticut Supreme Court cited *Chickasaw*, *Lawrence* and *Cohn* for the proposition that a state has virtually unlimited power to tax the income of any taxpayer classified as a resident in *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782, *cert. denied*, 120 S.Ct. 401 (1999). It described *Chickasaw* as "the Supreme

Court's subsequent emphatic reassertion . . . of the power of a state to tax all of the income of a domiciliary." *Chase Manhattan*, 249 Conn. at 188 n.16, 733 A.2d at 793 n.16. This view led the court to uphold a Connecticut income tax on all of a resident trust's income, even though the lack of a credit raised a risk of multiple taxation. However, unlike the Trusts' situation, there was no actual double taxation present in *Chase*.

These state court decisions on the income tax treatment of resident trusts and individuals contradict the *Complete Auto* framework established by this Court. This is a national issue because virtually every state taxes all of its residents' income. A resident should be free to invest anywhere in our national economy without being subjected to double taxation.

CONCLUSION

For the reasons stated, a writ of certiorari should issue to review the judgment of the Appellate Court of Illinois.

Respectfully submitted,

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APPENDIX A

FOURTH DIVISION
September 16, 1999

No. 1-98-1459

SIMON ZUNAMON, as Trustee of Oregon Trusts Nos. 1-208 and Washington Trusts Nos. 1-16, MARSHALL E. EISENBERG, as Trustee of A.N.P. Trusts Nos. 1-42 and R.A. Trusts Nos. 1-25, and CHARLES EVANS GERBER, as Trustee of F.L.P. Trusts Nos. 10-17 and 19-21,	) Appeal from the Circuit) Court of Cook County)) No. 96 L 51389)) The Honorable) John A. Ward,) Judge, Presiding.
Plaintiffs-Appellants,	
v.	
KENNETH E. ZEHNDER, Director of the Illinois Department of Revenue, and the ILLINOIS DEPARTMENT OF REVENUE,	
Defendants-Appellees.	

JUSTICE HOURIHANE delivered the opinion of the court:

Plaintiffs, the trustees of certain taxpayer trusts, appeal an order of the circuit court affirming a decision of the Illinois Department of Revenue (Department), which determined that the trusts are not entitled to a foreign tax

credit under section 601(b)(3) of the Illinois Income Tax Act (Act) (Ill. Rev. Stat. 1987, ch. 120, par. 1-101 et seq.) against their Illinois income tax liability for tax years prior to 1988, or against their replacement tax liability.

We reverse in part and affirm in part.

BACKGROUND

The underlying facts are undisputed. Each trust is a "resident" of Illinois for purposes of the Act. See Ill. Rev. Stat. 1987, ch. 120, par. 15-1501(a)(20). Only tax years ending on or before December 31, 1987 are in issue. For each such year in which the trusts earned income from a state other than Illinois, *i.e.*, from a "source state", they paid income tax to the source state on the income earned there.

On their federal income tax returns, the trusts each took a section 164 deduction for income taxes paid to a source state. See 26 U.S.C.A. § 164 (1986). On their Illinois returns for the same years, the trusts added back the federal deduction when calculating their "base income" under the Act, and then claimed a foreign income tax credit for taxes paid to a source state. The trusts also claimed a credit against their replacement tax liability.[1]

The Department disallowed both credits. It determined that, for the tax years in issue, the trusts were not permitted to add back the federal deduction taken for

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[1] The replacement tax credit did not include any credit for any source state tax which was previously claimed as an income tax credit.

source state taxes to their Illinois base income in order to preserve their ability to take the foreign tax credit. The Department also determined that the foreign tax credit applies only to income tax calculations and not to replacement tax calculations. The Department further rejected the trusts' arguments that disallowing the tax credits runs afoul of the uniformity clause of the Illinois Constitution (Ill. Const. 1970, art. IX, § 2), the federal due process clause (U.S. Const., amend. XIV, § 1), or the commerce clause (U.S. Const., art. 1, § 8). On administrative review, the circuit court affirmed the Department's decision, and this appeal followed.

ANALYSIS

Because the facts are undisputed and only questions of law are raised on appeal, review of the Department's decision proceeds *de novo*. *Nokomis Quarry v. Department of Revenue*, 295 Ill. App. 3d 264, 267, 692 N.E.2d 855 (1998).

Foreign Tax Credit

Under section 601(b) of the Act, the amount of income tax payable shall be the balance due after giving effect to, among other things, the following:

> (3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections

> 201(a) and (b) otherwise due under this Act for such taxable year. *** *The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income* for the taxable year." (Emphasis added.) Ill. Rev. Stat. 1987, ch. 120, par. 6-601(b)(3).

The "base income" of a trust is its federal taxable income. Ill. Rev. Stat. 1987, ch. 120, par. 2-203(c), (e)(1). In computing its federal taxable income, a trust is entitled to a deduction for state income taxes. 26 U.S.C.A. § 164 (1986).

Thus, a trust's base income necessarily reflects the federal deduction. Accordingly, a trust is precluded from taking the foreign tax credit unless it either forgoes the federal deduction for state income taxes, or adds back the federal deduction when calculating its base income. However, prior to the passage of Public Act 85-1200, effective August 24, 1988, section 203 of the Act prohibited any modifications to taxable income or base income except those expressly provided therein. Ill. Rev. Stat. 1987, ch. 120, par. 2-203(h).

Public Act 85-1200 amended section 203 of the Act by providing that the taxable income of a trust may be modified by adding thereto an amount equal to the tax deducted pursuant to section 164 of the Internal Revenue Code (IRC) (26 U.S.C.A. § 164 (1986)), if the trust is claiming the same tax for purposes of the foreign tax credit under section 601. However, the statutory amendment states that such modification is allowable "[f]or taxable years ending on or after January 1, 1989". Ill. Rev. Stat. 1989, ch. 120, par. 2-203(c)(2)(F).

In contrast to the foregoing provisions governing the taxation of trusts, the Act provides that the base income of an individual is calculated with reference to his or her "adjusted gross income", as defined in the IRC. Ill. Rev. Stat. 1987, ch. 120, par. 2-203(a), (e)(1). Adjusted gross income under the IRC does not include a deduction for state taxes. See 26 U.S.C.A. § 62 (1986). Thus, unlike a trust, an individual need not forgo the federal deduction in order to take the foreign tax credit.

With this statutory scheme in mind, we consider whether the trusts are entitled to take the foreign tax credit for the tax years in issue. The trusts argue that this court's decision in *Eisenberg v. Zehnder*, No. 1-97-0559 (1998) (unpublished order under Supreme Court Rule 23) is dispositive and requires reversal.

While the present case was pending in the circuit court, the same court had before it the *Eisenberg* case, in which certain resident trusts made the same arguments regarding their entitlement to the foreign tax credit. In *Eisenberg*, the circuit court reversed the decision of the Department, thus allowing the foreign tax credits. On appeal, we affirmed. However, while *Eisenberg* was pending before this court, the circuit court entered its ruling in the instant case. The circuit court determined that its reasoning in *Eisenberg* was faulty, and affirmed the Department's decision disallowing the tax credits. The trusts contend that, based on our decision in *Eisenberg*, the Department is collaterally estopped from relitigating the meaning of the subject provisions of the Act in the case at bar.

The doctrine of collateral estoppel bars the relitigation of issues decided in another action where (1) the issue decided in the prior adjudication is identical with the one presented in the present litigation; (2) there was a final judgment on the merits in the prior adjudication; and (3) the party against whom estoppel is asserted is a party or in privity with a party to the prior adjudication. *Illinois State Chamber of Commerce v. Pollution Control Board*, 78 Ill. 2d 1, 7, 398 N.E.2d 9 (1979). Although an unpublished order of the court is not precedential, it may be cited for limited purposes, including to support contentions of collateral estoppel. 166 Ill. 2d R. 23(e).

There is no question that the controlling legal issue in the *Eisenberg* case is identical to the initial issue raised in the case at bar, that there was a final judgment on the merits in *Eisenberg*, and that the party against whom estoppel is sought – the Department – was a party in that case. However, the Department maintains that collateral estoppel applies only to the relitigation of questions of fact, not to questions of law. See *Nokomis Quarry Co.*, 295 Ill. App. 3d at 267; *City of Chicago v. Chicago Fiber Optic Corp.*, 287 Ill. App. 3d 566, 576, 678 N.E.2d 693 (1997). But see *Morris v. Union Oil Co. of California*, 96 Ill. App. 3d 148, 153, 421 N.E.2d 278 (1981) (collateral estoppel forecloses relitigation of issues of either fact or law logically and legally necessary in reaching prior judgment); Restatement (Second) of Judgments § 27 (1980) (collateral estoppel applies to issues of evidentiary fact, ultimate fact, and issues of law essential to prior judgment).

We need not decide whether collateral estoppel applies here. Even if the Department is not estopped from relitigating identical issues of statutory construction, we

find no reason to depart from this court's analysis in *Eisenberg*. Accordingly, we reverse the Director's decision disallowing the foreign tax credits for pre-1988 tax years.

The cardinal rule of statutory construction is to ascertain and give effect to the intent of the legislature. Ordinarily, the best indicator of the legislature's intent is the language of the statute itself. *Nottage v. Jeka*, 172 Ill. 2d 386, 392, 667 N.E.2d 91 (1996). Although a statute should be interpreted, if possible, so that no clause or term is rendered superfluous (*Niven v. Siqueira*, 109 Ill. 2d 357, 365, 487 N.E.2d 937 (1985)), statutory provisions must also be harmonized and inconsistent phrasing may be modified, changed or rejected to conform to legislative intent (*Certain Taxpayers v. Sheahen*, 45 Ill. 2d 75, 83, 256 N.E.2d 758 (1970). Thus, where the letter of the statute conflicts with the spirit of the statute, the latter is controlling. *Bogseth v. Emanuel*, 261 Ill. App. 3d 685, 690, 633 N.E.2d 904 (1994), *aff'd* 166 Ill. 2d 507 (1995). Where an unambiguous statute is amended, a rebuttable presumption exists that the legislature intended to effect a change in the law. However, where a statute is ambiguous and thus fails to disclose clearly the legislature's intent, an amendment thereto may be deemed to operate merely as a clarification of existing law. *State of Illinois v. Mikusch*, 138 Ill. 2d 242, 252, 562 N.E.2d 168 (1990). Here, we are faced with interpreting a statute where an ambiguity existed prior to amendment, and where the "clarifying" amendment itself cannot, in part, be harmonized with the various statutory provisions.

There is no express indication in section 601 that the legislature intended the foreign tax credit to operate differently as to the various classes of "resident" taxpayers

(trusts, individuals and estates) to whom the credit is available. Further, there is no indication that the legislature intended to penalize a trust by making the tax credit unavailable simply because the trust sought to minimize its federal tax liability by taking a deduction for state income taxes. However, prior to amendment, section 203 prohibited any modifications to base income except those expressly provided therein. Thus, because a trust was seemingly prohibited from making the very addition to base income necessary to preserve its ability to take the foreign tax credit, the Department maintains that, for the tax years in issue, a trust had to choose between the federal deduction and the foreign tax credit.

The interpretation the Department advances is at odds with the purpose behind tax credits of this type, *i.e.*, the elimination of the potential for multiple taxation of a resident's income by reverting the tax to the state that is the source of the taxed income. See 2 J. Hellerstein and W. Hellerstein, State Taxation § 20.10 (1992). While a state is under no compulsion to provide foreign tax credits (see *Balla v. Department of Revenue*, 96 Ill. App. 3d 293, 295, 421 N.E.2d 236 (1981)), the Illinois legislature has made a policy decision to do so. Accordingly, we will not construe the statute in a way which defeats this policy by making the foreign tax credit unavailable to resident trusts.

Therefore, we read the language in section 601, which disallows the foreign tax credit "if any creditable tax was deducted in determining base income", not as evidence that the legislature intended to restrict a trust's ability to take the foreign tax credit, but as evidence that the legislature sought to foreclose a taxpayer from using *both* the

credit and the federal deduction to lessen its Illinois tax liability. Adding back the federal deduction to a trust's base income is consistent therewith. Although the Act did not, prior to amendment, expressly provide for such an addition to income, it is necessarily implied. A court will find an implied modification to income where necessary to effectuate the purpose of the Act. See *Continental Illinois National Bank & Trust Co. of Chicago v. Lenckos*, 102 Ill. 2d 210, 217-18, 464 N.E.2d 1064 (1984).

The amendment to section 203 clarifies the statute to the extent that it expressly allows a trust to make the necessary addition to income in order to avail itself of the foreign tax credit. However, the amendatory language which limits its application to tax years ending on or after January 1, 1989, is problematic. The absence of any indication in the statutory language that the legislature previously intended to limit a trust's ability to take advantage of the foreign tax credit, and the policy choice of the legislature in making this credit available to all resident taxpayers, make it impossible to reconcile and give meaning to the date restriction. This leads us to conclude that the inclusion of the same was an oversight. Thus, in order to harmonize the various statutory provisions and give effect to the true intent of the legislature, we now delete from section 203(c)(2)(F) of the Act the phrase, "For taxable years ending on or after January 1, 1989".

The Department maintains that the legislative history of the amendment requires a different result, and cites to *Kraft, Inc. v. Sweet*, 213 Ill. App. 3d 889, 572 N.E.2d 389 (1991), in support of this argument. In *Kraft*, prospective application of the amendment at issue found strong support in its legislative history. Here, the so-called "history"

on which the Department relies consists of nothing more than a vague and ambiguous, one-sentence comment made during the third-reading of the bill which contained the amendment. It hardly amounts to a clear expression of legislative intent, and is markedly different than the legislative history on which we relied in the *Kraft* decision.

For the foregoing reasons, we reverse the Department's decision which disallowed the foreign tax credit for tax years ending on or before December 31, 1987.[2]

Replacement Tax

The trusts next argue that they are entitled to a credit against their replacement tax liability for income taxes paid to another state. The "Personal Property Tax Replacement Income Tax", set forth in section 201(c) of the Act, is imposed on every corporation, partnership and trust on the privilege of earning or receiving income in or as a resident of Illinois. It is measured by net income and is in addition to all other occupation or privilege taxes. Ill. Rev. Stat. 1987, ch. 120, par. 2-201(c).

Section 601 provides that the foreign tax "shall be credited against the tax imposed by []section 201(a) and (b)". Ill. Rev. Stat. 1987, ch. 120, par. 6-601(b)(3). Thus, by

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[2] Initially, pre-1989 tax years were in issue. However, because the Department had issued instructions for 1988 allowing trusts to modify their base income by adding back the federal deduction, the trusts were allowed the foreign tax credit for that year. Thus, only pre-1988 tax years were at issue in this appeal.

its express terms, application of the foreign tax credit does not apply to the replacement tax found at section 201(c).

The trusts argue that this result subjects the trusts to double taxation, which runs afoul of the uniformity clause of the Illinois Constitution and the due process and commerce clauses of the United States Constitution.

In order to survive a challenge under the uniformity clause, a "nonproperty tax classification must be based on a real and substantial difference between the people taxed and those not taxed, and the classification must bear some reasonable relationship to the object of the legislation or to public policy." *Allegro Services, Ltd. v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250, 665 N.E.2d 1246 (1996) (*Allegro*). The legislature is given wide latitude in determining classifications for taxing purposes, and it is presumed that a statute is constitutional. The party challenging a tax classification bears the burden of demonstrating that it is arbitrary or unreasonable, and if a set of facts can reasonably be conceived that will sustain the classification, it will be upheld. *Allegro*, 172 Ill. 2d at 250-51.

The trusts argue that it is arbitrary and capricious to be treated differently than individuals, who may take a foreign tax credit to avoid multiple taxation of out-of-state-income. They also argue that it is arbitrary and capricious to be treated differently than corporations and partnerships who, although subject to the replacement tax, are taxed only on their income apportioned to Illinois under article 3 of the Act.

It is undisputed that trusts are a distinctive class for tax purposes. Indeed, the trusts acknowledge that a trust is fundamentally different than an individual, corporation, or partnership. The object of the Act is to tax the "privilege of earning or receiving income in or as a resident of this State". Ill. Rev. Stat. 1987, ch. 120, par. 2-201(a), (c). By virtue of their unique legal status, trusts exercise this privilege differently than individuals or other legal entities. See generally *Hanley v. Kusper*, 61 Ill. 2d 452, 461, 337 N.E.2d 1 (1975). Taxing all of their income, as residents of this state, is reasonably related to the purpose of the Act. See *National Realty & Investment Co. v. Department of Revenue*, 144 Ill. App. 3d 541, 549-51, 494 N.E.2d 924 (1986) (not granting corporations deduction allowed to other taxpayers not unreasonable or arbitrary in light of real and recognizable differences between corporations and other taxpayers). Further, the trusts do not argue that the actual tax they pay bears no reasonable relation to the privilege of earning or receiving income as a resident of this state. See *Illinois Gasoline Dealers Ass'n v. City of Chicago*, 119 Ill. 2d 391, 402, 519 N.E.2d 447 (1988).

The uniformity clause does not require that there be "perfect rationality" as to each taxpayer. Rather, it imposes only minimum standards of reasonableness and fairness between groups of taxpayers. *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill. 2d 239, 252, 606 N.E.2d 1212 (1992). These standards have been met here.

We also find no due process violation. The due process clause does not prohibit a state from taxing all of its residents' income, even income earned in another state. *Curry v. McCanless*, 307 U.S. 357, 368, 83 L. Ed. 1339, 59 S. Ct. 900 (1939) ("income may be taxed both by the state

where it is earned and by the state of the recipient's domicile"); see also 2 J. Hellerstein and W. Hellerstein, State Taxation § 20.10 (1992). While states commonly credit income taxes paid to other states, "this is an independent policy decision and not one compelled by jurisdictional considerations". *Oklahoma Tax Com'n v. Chickasaw Nation*, 515 U.S. 450, 463 n.12, 132 L. Ed. 2d 400, 115 S. Ct. 2214 (1995), quoting American Law Institute, Federal Income Tax Project: International Aspects of United States Income Taxation 6 (1987).

Finally, we find no merit to the trusts' remaining constitutional claim. The dormant or negative commerce clause is intended to prevent a state from engaging in economic isolationism. *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 420, 665 N.E.2d 795 (1996). That is to say, it prohibits state taxes and measures " 'designed to benefit in-state economic interests by burdening out-of-state competitors' ". *Geja's Cafe*, 153 Ill. 2d at 256, quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74, 100 L. Ed. 2d 302, 108 S. Ct. 1803 (1988). Under what is commonly referred to as the *Complete Auto* test, a state tax of interstate commerce will be upheld when it is applied to an activity that has a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977).

The trusts fail to cite any case in which the *Complete Auto* test has been applied to bar a state from taxing all of the income of its own residents. Indeed, the commerce clause is not intended "to protect state residents from

their own state taxes." *Geja's Cafe*, 153 Ill. 2d at 256, quoting *Goldberg v. Sweet*, 488 U.S. 252, 266, 102 L. Ed.2d 607, 109 S. Ct. 582 (1989). Rather, the commerce clause "protects markets and participants in markets, not taxpayers as such." *General Motors Corp. v. Tracy*, 519 U.S. 278, 300, 136 L. Ed. 2d 761, 117 S.Ct. 811 (1997). See also *Keller v. Department of Revenue*, 319 Ore. 73, 78, 872 P.2d 414 (1994) (*Complete Auto* does not alter rule that Oregon is entitled to tax income of its residents, including income derived from and taxed by another state); *Guzzardi v. Director, Division of Taxation*, 15 N.J. Tax 395, 408 (1995) (recognizing that in taxation of resident individuals, United States Supreme Court has not applied commerce clause principles).

The trusts have also failed to identify the interstate market or transaction purportedly implicated here. See *Tamagni v. Tax Appeals Tribunal*, 91 N.Y.2d 530, 540, 695 N.E.2d 1125 (1998) (prior to application of *Complete Auto* test, first step is to identify interstate market being subjected to discriminatory or burdensome taxation). It is not the mere possibility of multiple taxation which violates the *Complete Auto* test. Rather, the test is violated "when there is a risk of multiple taxation *which places a burden on interstate commerce* that is not also borne by intrastate commerce." (Emphasis added.) *Allegro*, 172 Ill. 2d at 267. The trusts make the unsupported claim that earning income from a state outside Illinois is the "essence of interstate commerce". We cannot agree with the broad sweep of this statement and decline to find a commerce clause violation here.

CONCLUSION

As to the foreign tax credit, we reverse the Department's decision, thus allowing the trusts to take the tax credit for the years in issue. As to the credit sought against the trusts' replacement tax liability, we affirm the Department's decision disallowing this credit.

Affirmed in part and reversed in part.

HARTMAN and THEIS, J.J., concur.

APPENDIX B

IN THE CIRCUIT COURT OF COOK COUNTY
COUNTY DEPARTMENT, LAW DIVISION
TAX AND MISCELLANEOUS REMEDIES SECTION

SIMON ZUNAMON, as Trustee of Oregon Trusts Nos. 1-208 and Washington Trusts Nos. 1-176) MARSHALL E. EISENBERG, as Trustee of A.N.P. Trust Nos. 1-42 and R. A. Trusts Nos. 1-25, and CHARLES EVANS GERBER, as Trustee of F.L.P. Trusts Nos. 10-17 and 19-21,	)	**96 L 51389**
Plaintiffs,	)	
v.	)	
KENNETH E. ZEHNDER, Director of the Illinois Department of Revenue, and the ILLINOIS DEPARTMENT OF REVENUE,	)	
Defendants.	)	

MEMORANDUM DECISION AND ORDER

This matter is before the court on the complaint of the plaintiffs which is brought pursuant to §3-103 of the Administrative Review Act (735 ILCS 5/3-103). The plaintiffs seek judicial review of a final administrative decision by the Defendant Kenneth E. Zehnder, Director of the Illinois Department of Revenue ("Department"). Based on the grounds below, the court finds this decision is neither

contrary to the manifest weight of the evidence nor contrary to law and accordingly affirms the decision.

SUMMARY OF FACTS

This case involves the determination by the Department that the Plaintiffs, who are the trustees for hundreds of individual trusts ("Trusts"), were not entitled to the income tax credit contained in §601(b)(3) of the Illinois Income Tax Act ("IITA"), nor to a credit against their replacement tax liability.

For the years at issue, these Trusts filed their income tax returns as resident trusts under IITA §1501(a)(20)(D). Certain of these Trusts, referred to as the Oregon Trusts, in fact were not Illinois residents, but erroneously filed in that capacity. All the Trusts received income from states ("source states" or "foreign states") other than Illinois in the taxable years at issue, from 1985 through 1987. The Trusts paid income tax to the source states in which this income was earned. In calculating their federal taxable income, the Trusts deducted the amount of income tax paid to the source states. When the Trusts filed their Illinois tax returns, no claim for credit was made for the taxes paid to the source states. When the Trusts made their Illinois refund claims by filing amended returns, again each filed as an Illinois resident and but now each claimed credit(s) against its Illinois income tax and/or replacement tax for the income taxes paid to the source states. Mechanically, the Trusts made these claims by adding back to their base income the amount of taxes paid to the source states which had been deducted in computing their federal taxable income. This addition

modification was done in an attempt to steer clear of the proviso in §601(b)(3) which disallows the credit "if any creditable tax was deducted in determining base income for the taxable year."

For the years at issue, the Department disallowed these credits, primarily on the basis that this addition modification to base income was not authorized until the legislature enacted §203(C)(2)(f) of IITA, which expressly applies only to taxable years ending on or after January 1, 1989. Thereafter, the Trusts timely filed this action for judicial review of the final administrative decision of the Director.

ISSUES PRESENTED

The issues presented may be expressed in general terms as follows:

1) Whether the Department correctly interpreted the IITA in ruling that the Trusts did not qualify for the credit provided by §601(b)(3) as a result of having deducted the amount of income tax paid to the source states in determining their federal taxable income?

2) Whether the IITA as interpreted by the Department is unconstitutional since resident trusts were subject to double taxation on income earned and taxed in the source states?

DECISION AND JUDGMENT

The first phase of the court's analysis involves determining whether the addition modification taken by the Trusts was authorized by the IITA. The second phase is

concerned with whether taxation by Illinois of all the income of a resident trust, including income earned and taxed in a source state, is constitutional.

For the following reasons, the court finds that the IITA did not allow the addition modification sought to be taken by the Trusts for the tax years at issue and that taxation by Illinois of all the income of these Trusts is not violative of the U.S. Constitution or the Illinois Constitution.

A.) Preliminary Matters

Before turning to the principal issues involved here, two preliminary matters deserve comment. First, the initial part of this decision dealing with issues of statutory construction is limited in scope to the question of whether the trusts are entitled to a credit against their income tax liability under the IITA. As noted above, the trusts are claiming credits for the taxes paid to source states against both their income tax liability as well as their replacement tax liability. However, it is undisputed that the IITA contains no provision allowing a credit for taxes paid to source states against replacement tax liability under any circumstance. Despite the absence of a statutory provision allowing for such a credit against their replacement tax liability, the trusts nevertheless ask this court to delete certain language contained in §601(b)(3) so as to create such a credit. *Plaintiff's Opening Memorandum*, at 19. Unless compelled to do such an extraordinary act to save the Act from being declared unconstitutional, the court could not properly delete certain language from its construction of §601(b)3. Thus, the

court will treat the issue of whether the Trusts are entitled to a credit against their replacement tax liability only in the second part of this decision pertaining to whether Illinois is constitutionally mandated to provide a credit against income earned in source states.

The second preliminary point is that in a related case involving circumstances largely indistinguishable from those presented here, this court held that the IITA authorized the addition modification at issue. In that case, *Marshall Eisenberg v. Director of Department of Revenue*, 90 L 51099, the tax year 1987 was at issue. After the submissions of briefs and after extensive argument, it was disclosed at a supplemental hearing that the Department had issued tax return instructions for trusts which stated that trusts were entitled to take this addition modification for tax years ending in 1988. The court found this instruction to be inconsistent with the position taken by the Department in that case because there was no statutory change between 1987 and 1988. The court's construction analysis was colored throughout by frustration from not having earlier learned that the Department had itself read into the Act an implied addition modification for the tax year 1988 and the court concluded that there was no good basis to deny this same modification for earlier years. As noted earlier, §203(c)(2)(F), which expressly allows the addition modification, only applies to tax years ending on or after January 1, 1989.

Upon reflection, it occurs to the court now that its earlier analysis of the IITA weighed too heavily the Department's instructions for tax year 1988. In fact, the court in that decision noted that the result was not without its blemishes: "(O)ften in tax cases there is not an

ideal solution to problems of interpretation which fits neatly into the imperfect labyrinth of the Act." *Eisenberg*, at 14-15. Therefore, while instructions are not without relevance to issues of statutory construction, the court now considers other factors to be more compelling in deciding whether the legislature intended there to be an addition modification for the years at issue here. For the reasons stated below, the court finds these other factors outweigh the Department's instructions in deciding whether the trusts properly took the addition modification.

B.) The Illinois Income Tax Act

The parties have advanced a number of intricate and well-presented arguments in support of their respective positions regarding whether the IITA allowed the addition modifications taken by the Trusts. The weighing of these arguments is primarily an exercise in statutory construction which focuses upon two key provisions of the Act, namely §601(b)(3) and §203(c)(2)(F).

In construing a statute, the primary goal is to render a meaning to the provision which accurately reflects the intent of the legislature. To achieve this end, a court may look to many factors as bearing on the legislative intent. The Supreme Court has detailed this process of statutory construction in the following terms:

> (T)he primary rule is to ascertain and give effect to the intention of the legislature, and that inquiry must begin with the language of the statute. In addition to considering the language of the statute, a court may properly consider the purposes to be attained by the law, the necessity

> for the law and the evils sought to be remedied. The legislative history or background of a statute (e.g., legislative committee reports as well as House and Senate floor debates) may be an instructive resource in ascertaining the legislative intent. We also note that, generally, administrative interpretations of a statute promulgated by the agency charged with the administration and enforcement of the statute receive some respect and deference from the courts, but they are clearly not binding on the courts. In addition, this court has noted that "(a)dministrative rules can neither limit nor extend the scope of a statute."

Van's Material Co. v. Dept. of Revenue (1989), 131 Ill.2d 196, at 202-03. (Citations omitted.)

Relative to a statute granting a tax exemption or credit, this court must resolve issues of construction relative to the scope of the exemption or credit so as to favor taxation. The Appellate Court has set forth the general burdens of a taxing entity and of a taxpayer in the following terms:

> Ordinarily, the taxing authority has the burden of proof regarding a taxpayer's liability to the government. (Cornett-Lewis Coal Co. v. Commissioner of Internal Revenue (6th Cir. 1944), 141 F.2d 1000.) For example, the taxing authority bears the burden of proving that the taxpayer actually received income (Thomas v. Commissioner of Internal Revenue (6th Cir. 1955), 233 F.2d 83), and that such income is properly subject to taxation (Miller v. United States (7th Cir. 1961), 296 F.2d 457). The Illinois legislature, in order to aid the Department in meeting its burden of proof in this respect, has provided that

> the findings of the Department concerning the correct amount of tax due are prima facie correct. (Ill. Rev. Stat. 1979, ch. 120, par. 9 – 904(a).) When the taxpayer introduces credible evidence to the contrary, the burden is again placed on the Department to prove its contentions by a preponderance of the evidence. Goldfarb v. Department of Revenue (1952), 411 Ill. 573, 104 N.E.2d 606.
>
> However, when a taxpayer claims that he is exempt from a particular tax, or where he **seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer**. (Telco Leasing, Inc. v. Allphin (1976), 63 Ill. 2d 305, 347 N.E.2d 729; Bodine Electric Co. v. Allphin (1980), 81 Ill. 2d 502, 410 N.E.2d 828; 47 C.J.S. Internal Revenue @ 372 (1946).) **This derives from the fact that deductions and exemptions are privileges created by statute as a matter of legislative grace.** (Bodine Electric Co. v. Allphin.) **Statutes granting such privileges are to be strictly construed in favor of taxation.** Telco Leasing, Inc. v. Allphin.

Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist., 1981) (Emphasis supplied.)

Turning to §603(b)(3), that section provides for a credit against income liability for taxes paid to a source state by a resident:

> (3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act [35 ILCS 5/201] shall be credited against the tax imposed

> by subsections 201(a) and (b) [35 ILCS 5/201] otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) [35 ILCS 5/201] otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. For purposes of this subsection, no compensation received by a resident which qualifies as compensation paid in this State as determined under Section 304(a)(2)(B) [35 ILCS 5/304] shall be considered income subject to tax by another state or states. **The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year.** Any person claiming such credit shall attach a statement in support thereof and shall notify the Director of any refund or reductions in the amount of tax claimed as a credit hereunder all in such manner and at such time as the Department shall by regulations prescribe.

35 ILCS 601(b)(3) (Emphasis supplied.)

The highlighted language must be construed in conjunction with §203(h) of the Act. That provision generally prohibits implied modifications to income:

> (h) Legislative intention. Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted

> gross income or taxable income for federal income tax purposes for the taxable year, . . .

35 ILCS 5/203(h).

These provisions form a clear image of the intent of the legislature relative to the issue presented: Once a trust deducts the amount of foreign state income tax paid in computing its federal taxable income, *i.e.* base income, it loses the ability to claim the credit under §601(b)(3) as to this amount. Stated differently, the addition modification proposed by the Trusts not only is implied, but it conflicts with the express language of both §601(b)(3) and §203(h).

Consistent with the notion that the addition modification taken by the Trusts was contrary to the intent of the legislature when it enacted §601(b)(3) is the amendment to the IITA found in §203(c)(2)(F). This section, which expressly applies only to taxable years ending on or after January 1, 1989, provides that if a trust deducts its state income tax from its federal taxable income, it may add back that amount in the computation of its Illinois base income so that the credit under §601(b)(3) is not lost. In other words, §203(c)(2)(F) contains the explicit legislative grant for the addition modification which the Trusts seek to imply. The question which arises is whether the legislature intended this section to be a clarification or a change of the existing law. This section provides:

> (F) For taxable years ending on or after January 1, 1989, an amount equal to the tax deducted pursuant to Section 164 of the Internal Revenue Code [26 U.S.C. @ 164] if the trust or estate is claiming the same tax for purposes of

> the Illinois foreign tax credit under Section 601 of this Act [35 ILCS 5/601];

35 ILCS 5/203(c)(2)(F).

The court agrees with the Department that this provision may not be viewed as a clarification of the law prior to its enactment, but rather must be seen as a change in the law. This conclusion is compelled since the legislature limited its application to "taxable years ending on or after January 1, 1989." As found by the Appellate Court in *Kraft, Inc. v. Sweet*, 213 Ill.App.3d 889, 897-98 (4th Dist., 1991), such a proviso limiting an amendment to application after a certain date indicates that the legislature did not mean to clarify existing law, but rather intended to change the law. "The proviso that the subtractions for subpart F deemed income is available for tax years ending on or after December 31, 1988, strongly supports the conclusion that the legislation permitting this subtraction was not intended to clarify an existing statute."

The proviso of a prospective effective date also distinguishes the present issue of whether §203(c)(2)(F) was meant as a clarification or change of existing law from the issue presented to the Supreme Court in *Continental Illinois National Bank and Trust Co. v. Lenckos* (1984), 102 Ill.2d 210. In that case, the Court found that the tax amendment at issue, 35 ILCS 5/203(b)(2)(I), was intended to clarify the law. However, that amendment did not contain a provision limiting its application to a taxable year ending on a particular date, as does §203(c)(2)(F).

Further support that §203(c)(2)(F) was intended to be a change in the existing law is found in its legislative history. At the third reading of House Bill 3512, Senator

Rigney explained the proposed legislation, and its two amendments which are irrelevant here, as follows:

> Mr. President, in its original form, this was merely a technical bill. **It made some changes as far as those folks who are filing trusts in the states for tax deducted in computing Federal Income Tax income.** There were two amendments that were put on. One is for new taxpayers to the State of Illinois who are entitled to this one percent growth in base employment for the first year. It makes it clear that those firms that are new to Illinois will be eligible for this income tax credit, and I think you'll recall that Senator Etheredge also put on his super collider amendment on this bill.

85th Ill. Gen. Assem., Senate Proceedings, June 17, 1988 at 57.

Because §203(c)(2)(F) was intended to change the law, the legislature must have understood prior to that section's effective date that the foreign tax credit was irretrievably lost if a deduction had been taken for the foreign tax paid in computing base income. This legislative understanding is further proof that no addition modification may be implied from §601(b)(3) for the tax year at issue.

In conclusion, based on the language of §601(b)(3), as well as the fact that the change in the law effected by §203(c)(2)(F) is limited to tax years ending on or after January 1, 1989, the court concludes that the foreign tax credit was not available to the trusts for the taxable years at issue.

C). Constitutional Claims

In holding that for the tax years at issue, §601(b)(3) was intended to disallow a credit for income tax paid to source states where the amount of that tax had been deducted in determining base income, it becomes necessary for the court to address the constitutional issues presented. As noted earlier, the constitutional discussion below also pertains to the claims of the Trusts that Illinois is constitutionally required to allow a credit against its replacement tax for income tax paid to source states.

A logical starting point for analysis is the undeniable proposition that a state has the power to tax all of the income of its residents, including its resident trusts. This proposition is expressed in IITA by virtue of §301, which provides in relevant part as follows:

> General Rule
>
> (a) Residents. All items of income or deduction which were taken into account in the computation of base income for the taxable year by a resident shall be allocated to this State.

35 ILCS 5/301(a).

Hellerstein states the proposition in simple terms and without equivocation:

> The States' constitutional power to tax residents on all of their personal income from whatever source derived is well established.

J. Hellerstein and W. Hellerstein, II State Taxation §20.04(1)(1992).

From this starting point is formed that which is in dispute, namely, that since Illinois may, and does, impose

its income tax on all the income of a resident trust, is it constitutionally required to allow a credit for taxes paid to other states for income earned and taxed in those states? The Trusts maintain that such a credit must be allowed by the court so that the IITA does not run afoul of the Commerce and Due Process Clauses of the U.S. Constitution or the Uniformity Clause of the Illinois Constitution. Because the federally-based claims are closely related, they will be examined together, while the claim based on the Uniformity Clause will be examined separately.

Commerce and Due Process Clauses

The Commerce Clause, which is found at Art. 1 Section 8, cl.3 of the Constitution, states that, "(t)he Congress shall have Power . . . to regulate Commerce . . . among the several States." Hidden beneath the explicit grant of Congressional authority over commerce is a more sublime dimension to the Clause, namely, the implied limitation imposed on the states' power to tax interstate commerce. This dimension has been termed the clause's negative aspect and its importance was paramount to the Framers. In a letter written by James Madison, this focus was evident as he wrote that the Clause was intended "as a negative and preventive provision against injustice among the States themselves, rather than as a power to be used for the positive purposes of the General Government." Madison stated that the need for the clause arose "out of the abuse of the power by the importing States in taxing the non-importing . . . " 3 M. Farrand, Records of the Federal Convention of 1787, p. 478 (1911).

Historically, most disputes arising under the Commerce Clause have been concerned with this negative aspect and have arisen as a result of the inherent tension between the efforts of the states to raise revenues and those engaged in interstate commerce. Resolution of these tensions has been the recurring business of the Supreme Court, which has struck various balances at different times in the country's history. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, ___ U.S. ___, 115 S.Ct.1331 (1995). In the early stages, the Court held that interstate commerce was wholly immune from state taxation "in any form," *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888), "even though the same amount of tax should be laid on [intrastate] commerce," *Robbins v. Shelby County Taxing Dist.*, 120 U.S. 489, 497(1887). A century later, and after the rise and fall of numerous interpretations, the present approach to determine whether a state or local tax violates the Commerce Clause focuses upon four factors:

> (A) state tax is not *per se* invalid because it burdens interstate commerce since interstate commerce may constitutionally be made to pay its way. (Citations omitted.) The State's right to tax interstate commerce is limited, however, and no state tax may be sustained unless the tax: (1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to services provided by the State. (Citation omitted.)

Maryland v. Louisiana (1981), 451 U.S. 725, 754, 68 L. Ed. 2d 576, 600, 101 S. Ct. 2114, 2133.

These four tests are often referred to as the *Complete Auto* tests, so named because of the decision of the Court

in *Complete Auto Transit, Inc. v. Brady* (1977), 430 U.S. 274. Except for the third test that the tax not discriminate against interstate commerce, the other tests are also contained within the Due Process Clause. *See*, J. Hellerstein and W. Hellerstein, II State Taxation §20.04(1) (1992).

It is clear that the Illinois taxing scheme for resident trusts for the taxable years at issue would not pass constitutional muster under *Complete Auto*. For example, under the third test, by imposing a second level of state taxation on income earned outside Illinois by trusts without a credit for the tax paid to the source states, Illinois' taxing scheme benefits Illinois economic interests while burdening economic interests outside Illinois. Stated differently, the taxing scheme at issue gives a competitive edge to Illinois investment opportunities since Illinois trusts investing in those opportunities would not be subject to the double taxation which would be imposed on income earned from investments outside Illinois. *See, Oregon Waste Systems, Inc. v. Department of Environmental Quality*, ___ U.S. ___, ___, 114 S.Ct. 1345, 1349 (1994). However, the question remains as to whether the analysis and tests of *Complete Auto* are properly applied to measure the constitutionality of a state tax imposed not on a business enterprise engaged in interstate commerce, but rather on a resident.

It is the position of the Department that *Complete Auto* was not intended to affect the long-established principal that a state may tax all the income of its residents, regardless of where earned and regardless if double taxation results. The Department maintains that the decisions of the Supreme Court in *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932) and *New York ex rel. Cohn v. Graves*, 300

U.S. 308 (1937), where the Court commented on the power of a state to tax all the income of its residents, remain vital after *Complete Auto*.

The Trusts urge that the four tests of *Complete Auto* should be applied to Illinois' income tax on resident trusts and that the tax fails the first three tests.

There are several recent decisions which bear upon the issue of whether the tests of *Complete Auto* were intended to be applied to various state taxes imposed on individual residents. In *Department of Revenue v. Kehnlein*, 646 So.2d 717 (S.Ct.Fla., 1994), the Supreme Court of Florida focused on the third test of *Complete Auto* and found that an impact fee imposed on state residents who purchased or titled automobiles in other states and then registered them in Florida was impermissibly discriminatory. "Here, there can be no question but that a burden is placed on some out-of-state economic interests. Specifically, Florida has erected a financial barrier that gives Florida used-car sellers a substantial advantage over similar out-of-state sellers." 646 So.2d at 724.

Similarly, in *Fulton Corporation v. Justus*, 430 S.E.2d 494 (Ct.of Appeals of N.Car., 1993), the court applied *Complete Auto* to an intangibles tax which increased the tax liability for those residents who owned stock in corporations whose business and property were not completely located in North Carolina. "Applying these principles to North Carolina's intangibles taxing scheme, we find that the tax facially discriminates against interstate commerce. Shareholders of out-of-state corporations are required to pay intangibles taxes on a higher percentage of shares than shareholders of corporations operating

solely in North Carolina. . . . The tax forecloses tax-neutral decisions and creates an advantage for firms operating in North Carolina." 430 S.E.2d at 498.

In a third decision, *St. Ledger v. Kentucky*, 912 S.W.2d 34 (S.Ct.Kentucky, 1996), the Supreme Court of Kentucky found that the higher taxation imposed on residents for out-of-state bank deposits than on in-state deposits violated the third test of *Complete Auto*:

> Residents making a choice of where to deposit funds will be influenced by the higher tax rate on out-of-state deposits. As a result, the statute "forecloses tax-neutral decisions and creates both an advantage for the (banks in Kentucky) and a discriminatory burden on commerce to its sister States." Boston Stock Exchange, 429 U.S. at 331, 97 S.Ct. at 608.

912 S.W.2d at 39.

In the same decision, the Court upheld the constitutionality of an ad valorem tax on corporate shares. Although the court found that the tax, on its face, discriminated against interstate commerce, it was not unconstitutional because it was a compensatory tax designed to level the tax field. 912 S.W.2d at 42-43. (*See*, also, *Indiana Department of State Revenue v. Felix*, 571 N.E.2d 287 (S.Ct.Indiana, 1991) (The Supreme Court of Indiana upheld a similar tax on residents owning shares of stock in non-Indiana corporations. Stock in Indiana corporations was exempt from taxation. According to the Court, this tax was compensatory.)

Finally, in the case most closely resembling the present, the Supreme Court of Oregon was presented with

the issue of whether the Commerce Clause required that state to grant a credit to the taxpayers who were Oregon residents who worked in the state of Washington. Washington imposed a business and occupation tax. The Court first found that the taxpayers were not entitled to a credit because the Washington tax was an excise tax, not an income tax, and that the Oregon provision granting a credit only applied where income tax had been paid to another state. In regard to the constitutional issues raised by the taxpayers, the Court stated as follows:

> Taxpayers argue, in the alternative, that the Oregon and federal constitutional provisions on which they rely compel Oregon either to allow the credit that they seek under ORS 316.082 or to refrain from taxing the portion of their income earned in Washington. They rely on Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S Ct 1076, 51 L. Ed. 2d 326 (1977), and other authorities for the contention that, without a credit for the Washington B & O tax, Oregon's income tax discriminates against interstate commerce and deprives taxpayers of due process and equal protection of the law. We reject taxpayers' arguments, because they proceed from the faulty premise that the Washington B & O tax is an income tax. We have rejected that proposition. **We nonetheless do not read Complete Auto Transit, Inc. to alter the rule that Oregon is entitled to tax the income of its residents.** See Lawrence v. State Tax Comm., 286 U.S. 276, 52 S Ct 556, 76 L Ed. 1102 (1932) (holding that domicile established a basis for taxation of income). The state's taxing authority extends to all of the income earned by its residents, including income earned outside the state. Greenough

> v. Tax Assessors, 331 U.S. 486, 491, 67 S Ct 1400, 91 L Ed 1621 (1947); Lawrence v. State Tax Comm., supra, 286 U.S. at 281; Denniston v. Dept. of Revenue, 287 Or 719, 724, 601 P2d 1258 (1979). We find nothing in the authorities cited by taxpayers that suggests that, in denying a credit for the B & O tax, Oregon has exceeded its authority to levy an income tax on its residents.

319 Ore. at 78.

See, also, *Estate of Guzzardi v. Director*, 15 N.J.Tax 395, 406 (Tax Ct., 1995) ("As indicated above, . . . a state may constitutionally tax a resident individual on all income received, regardless of its source. That rule creates a risk of multiple taxation which would be suspect under the commerce clause. . . . In the taxation of resident individuals on their income or intangible property, however, the (Supreme) Court has not applied commerce clause principles, perhaps on the theory that 'income from interstate business' is not involved, (citation omitted) or that the privilege of a resident to receive income or own intangible property is an 'event facilitated by the laws and amenities' of the state of residence, which gives that state the power to tax without apportionment. (Citations omitted.)")

After considering these decisions, and the arguments of the parties, the court concludes that *Complete Auto* has not changed the principle recited in *Lawrence v. State Tax Comm'n.*, 286 U.S. 276 (1932) and in *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937). that a state may tax all the income of its residents, regardless of whether this same income is taxed by another state and regardless of whether the state of residency allows credit for the taxes

paid to another state. That these decisions remain controlling and vital is seen by the fact that the Supreme Court continues to rely on them. In *Oklahoma Tax Comm'n v. Chickasaw Nation*, 115 S.Ct. 2214(1995), the Court began its analysis of whether Oklahoma could impose its income tax on certain members of the Chickasaw Nation by reference to *Graves* and the principle that a state may tax all the income of its residents:

> The holding on tribal members who live in the State outside Indian country runs up against a well established principle of interstate and international taxation – namely, that a jurisdiction, such as Oklahoma, may tax all the income of its residents, even income earned outside the taxing jurisdiction:
>
> "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government. . . . These are rights and privileges which attach to domicil within the state. . . . Neither the privilege nor the burden is affected by the character of the source from which the income is derived." New York ex rel. Cohn v. Graves, 300 U.S. 308, 312-313, 57 S.Ct. 466, 467-468, 81 L.Ed. 666 (1937).
>
> This "general principl[e] . . . ha[s] international acceptance." American Law Institute, Federal Income Tax Project: International Aspects of United States Income Taxation 4, 6 (1987); see, e.g., C. Cretton, Expatriate Tax Manual 1 (2d ed.

> 1991) ("An individual who is resident in the UK is subject to income tax on all his sources of income, worldwide."). It has been applied both to the States, e.g., Shaffer v. Carter, 252 U.S. 37, 57, 40 S.Ct. 221, 227, 64 L.Ed. 445 (1920); see 2 J. Hellerstein & W. Hellerstein, State Taxation §20.04, p. 20-13 (1992), and to the Federal Government. E.g., Cook v. Tait, 265 U.S. 47, 56, 44 S.Ct. 444, 445, 68 L.Ed. 895 (1924); see 1 J. Isenbergh, International Taxation 45-56 (1990).

115 S.Ct. at 2222-23. (Footnotes omitted.)

Of further importance is that the Court also addressed whether a state was constitutionally required to provide credits to its residents so as to avoid double taxation on income earned in another jurisdiction:

> Although sovereigns have authority to tax all income of their residents, including income earned outside their borders, they sometimes elect not to do so, and they commonly credit income taxes paid to other sovereigns. But "(I)f foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and not one compelled by jurisdictional considerations." American Law Institute, Federal Income Tax Project: International Aspects of United States Income Taxation 6 (1987).

115 S.Ct. at 2223, n.12.

There can be no harmonious reconciliation between this pronouncement of the Court and the Trusts' argument that a state may no longer tax all the income of its residents unless it provides credit to avoid double taxation on that income earned and taxed outside the state.

Furthermore, there is significance in the fact that the Supreme Court in *Complete Auto* and related decisions was silent in regard to the holdings in *Lawrence* and *Graves*. It is safe to assume that the Court did not overlook these foundational decisions, but rather viewed the constitutional analysis applicable to issues involving a state's power to tax interstate commerce as being distinct from analysis relating to a state's power to tax its residents.

In conclusion, the court rejects the arguments of the Trusts that the Commerce Clause and the Due Process Clause do not allow Illinois to impose its income tax on all their income without allowing a credit for the income tax paid to source states. By so holding, the court in no way means to convey the impression that the Act's treatment of resident trust for the years at issue was fair or wise. Clearly, it was neither, but the result does not violate the U.S. Constitution.

Uniformity Clause

The Trusts complain that, because a resident trust is subject to double taxation on income earned and taxed in other states, while resident individuals, partnerships and corporations are not, the Uniformity Clause is violated. While this argument may appear reasonable when measured against an undefined, abstract notion of uniformity, when measured against the Uniformity Clause of the Illinois Constitution, it is left hollow.

Examination properly begins with the Clause itself, which provides "[i]n any law classifying the subjects or objects of non-property taxes or fees, the classes shall be

reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable." Ill. Const. 1970, art. IX, §2.

The decisions interpreting the Clause provide clear guidance here to measure the Trusts' challenge. "The uniformity requirement, as traditionally understood, may be violated by classifications which are either 'under-inclusive' or 'overinclusive.' " *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250 (1996) (citing G. Braden & R. Cohn, The Illinois Constitution: An Annotated and Comparative Analysis, 416 (1969)). However, "[t]he uniformity clause was not designed as a straitjacket for the General Assembly." *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill.2d 239, 252 (1992). "Rather, the uniformity clause was designed to enforce minimum standards of reasonableness and fairness as between groups of taxpayers." *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill.2d 239, 252 (1992).

"Article IX, section 2 . . . is not a general limitation on legislative action but is addressed specifically to the General Assembly's power to classify for nonproperty tax purposes." *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 466 (1987). "Section 1 of article IX of the 1970 Illinois Constitution specifically provides that the General Assembly may raise revenue 'except as limited or otherwise provided in this constitution.' " *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 466 (1987). However, "[t]he apparent grant of the power to tax in section 1 of article IX is not in fact a grant of power but is merely an affirmation of the sovereign

power of the State and the inherent power of the General Assembly to tax." *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 466 (1987) (citing Young, "The Revenue Article of the Illinois Constitution of 1970 – An Analysis and Appraisal," 1972 U.Ill.L.F. 312, 312-14). "Thus, the power to tax . . . could have been exercised by the General Assembly even though there were no constitutional provisions such as that contained in section 1 of article IX of our constitution, and in the absence of limitations such as those in section 2 of article IX, the taxing power would, nonetheless, be subject to the limitations of the equal protection clauses of the State and Federal constitutions." *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 466 (1987).

"Although the report of the Committee expressed the intent that the court construe the limitations on the taxing power contained in section 2 of article IX as being broader than that of the equal protection clause, it also expressed its intention that the courts should not severely limit the State's broad power to tax." *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 467 (1987) (citing 7 Record of Proceedings, Sixth Illinois Constitutional Convention 2062, 2066 (Report of the Committee on Revenue and Finance, Section 1 – State Revenue Power)).

"To survive scrutiny under the uniformity clause, a non-property tax classification must be based on a real and substantial difference between the people taxed and those not taxed, and the classification must bear some reasonable relationship to the object of the legislation or to public policy." *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250 (1996) (citing

Searle Pharmaceuticals, Inc. v. Department of Revenue, 117 Ill.2d 454, 468 (1987); *Northern Illinois Home Builders Ass'n v. County of Du Page*, 165 Ill.2d 25, 44-45 (1995); *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill.2d 239, 247, 180 (1992); *Federated Distributors, Inc. v. Johnson*, 125 Ill.2d 1, 15 (1988)). However, "[a]lthough the uniformity clause imposes a more stringent standard than the equal protection clause, the scope of a court's inquiry under the uniformity clause remains relatively narrow." *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250 (1996) (citing *Geja's Cafe*, 153 Ill.2d at 248). "[T]he 'real and substantial difference' standard merely represents the minimum level at which the differences among groups are of a sufficient magnitude to justify taxing the groups differently." *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 253 (1996).

"Statutes bear a presumption of constitutionality, and broad latitude is afforded to legislative classifications for taxing purposes." *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250 (1996) (citing *Geja's Cafe*, 153 Ill.2d at 248). "One challenging a non-property tax classification has the burden of showing that it is arbitrary or unreasonable, and if a state of facts can reasonably be conceived that would sustain the classification, it must be upheld." *Allegro Services v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250-51 (1996) (citing *Geja's Cafe*, 153 Ill.2d at 248).

Turning back to the arguments of the Trusts, it is doubtful whether the Trusts have met the threshold requirement for a good-faith challenge under the Uniformity Clause. *See, Terry v. Metropolitan Pier and Exposition*

Authority, 271 Ill.App.3d 446, 454 (1st Dist., 1995) (Finding that the plaintiffs there failed to raise a good faith challenge.) Here, because of the transparency of "real and substantial differences" between resident trusts and other taxpayers, it could be safely concluded that the Uniformity Clause was not violated as a result of the unavailability of the foreign tax credit to the Trusts.

Nevertheless, the court will assume that the Trusts have raised a good faith challenge and will examine the two principal contentions of the Trusts separately.

Turning to their first argument, the Trusts contend that a Uniformity Clause violation arises because of the following result under the IITA:

> A corporation or a partnership is subject to Illinois income and Replacement Tax only on the amount of income which is sourced to Illinois under Article 3 of the Act. A corporation's right to apportionment under Article 3 is not affected by whether it deducts state income taxes on its federal return. By contrast, a resident trust is taxable on all of its income, regardless of where it is earned. *See* Act §301(a). Thus, without the Income and Replacement Tax Credits, the Act will impose double taxation on Illinois resident trusts with non-Illinois income.

Plaintiff's Opening Memorandum, at 25.

The Trusts conclude this argument by repeating the contention that, "There is no authority which would permit the state of residency to tax income which was previously taxed in the state where it was earned." *Plaintiff's Opening Memorandum*, at 26.

Again, the court believes that this argument ignores the obvious. Trusts are as different from partnerships and corporations for purposes of taxation as day is from night. At a fundamental level, trusts have a different purpose than partnerships and corporations. "(A) trust is an artificial legal device by which some of the consequences that would ordinarily attach to the ownership of property by a natural person may be avoided." *Hanley v. Kusper* (1975), 61 Ill.2d 452, 461. Partnerships and corporations, on the other hand, generally have as their *raisons d'etre* the production of income through commercial activities.

In the area of taxation, trusts are typically treated differently than are partnerships and trusts. *See*, IRC §§671-683. Most germane here is the different treatment accorded to those trusts which are classified as "residents" under the IITA. Generally, trusts which are defined as residents under §1501(a)(20) are those which feature a close and unique connection to Illinois. The close and unique connection of residency may be established in one of two ways: A trust is considered a resident if it is created by the will of a decedent who was domiciled in Illinois at the time of death or if it became irrevocable while the grantor was domiciled here.

The Trusts are residents under the IITA, and their inclusion in that classification has not been challenged. Partnerships and corporations are excluded from the definition of resident. Thus, while the Trusts portray the classification at issue as being between trusts on the one hand and partnerships and corporations on the other, in reality it is a challenge of the different treatment afforded residents and non-residents under the IITA. As found by

the administrative law judge, there are differences between residents and non-residents which justify the classification challenged by the Trusts:

> There are real and substantial differences between residents and non-residents for purposes of taxation. That fundamental classification is based on a state's constitutionally limited by principles of due process, equal protection and interstate commerce power to tax only that portion of a non-resident's income that fairly reflects the non-resident's activities in the taxing state. (Citation omitted.).
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> * * * *
>
> In the case of non-residents, tax is imposed upon the privilege of earning or receiving income *in* Illinois. In the case of residents, tax is imposed upon the privilege of earning or receiving income *as a resident of* Illinois.

R., at 386

The court agrees that the classification within the IITA of some trusts as residents, and the exclusion of all partnerships and corporations, is necessitated by the fact that there is a "real and substantial difference" between Illinois' ability to impose its tax on its residents and Illinois' ability to impose its tax on non-residents. For this reason, the court rejects the argument of the Trusts that the Uniformity Clause was violated by the classification between resident trusts and partnerships and corporations.

As to the second classification challenged by the Trusts, that resident trusts are treated differently than resident individuals relative to the availability of credits

to offset foreign income, again there is ample difference between the subjects of these classifications to justify the separate results. As expressed by the Supreme Court, individuals and trusts are not kindred spirits in conception, purpose, or end:

> Neither a trustee nor a beneficiary owns property as a natural person does. Like a corporation, a partnership, and an unincorporated association, a trust is an abstraction – a legal creation designed to enable natural persons who own property to achieve results that could not be achieved if they continued to own it as natural persons. The issue in this case is not a moral one, although the Bank quotes Learned Hand's statement that "there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible." (Commissioner v. Newman (2d Cir. 1947), 159 F.2d 848, 850-51.) What we are called upon to do here is to define the meaning of the word "individuals" in a context that contrasts the ownership of a natural person with other kinds of ownership.
>
> There is no doubt that a trust is an artificial legal device by which some of the consequences that would ordinarily attach to the ownership of property by a natural person may be avoided. The objective may be to defeat the claims of creditors of the settlor or of the beneficiary (see G. Bogert, The Law of Trusts and Trustees, sec. 244, 246 (2d ed. 1964)), or to avoid income or inheritance taxes (see Bogert, ch. 15; 1 A. Scott, The Law of Trusts, sec. 59 (3d ed. 1967)). It may be in part to conceal actual ownership, as in the case of the land trust (see Bogert, sec. 250) or to secure a more skillful management or greater

> diversification of investments than an individual owner is able to achieve as a natural person (Bogert, sec. 249). The objective may even be to obtain corporate advantages without incorporation. "The most common type of business trust is that where the owners of a business, or of shares in a business corporation, transfer the property of the business, or all or a large part of the stock, to trustees for themselves." Bogert, sec. 270.40, at 347.

Hanley v. Kusper (1975), 61 Ill.2d 452, 461.

These broad and fundamental differences between trusts and individuals may be productively compared to the types of classifications found to be violative of the Uniformity Clause in various decisions. In *Searle Pharmaceuticals, Inc. v. Department of Revenue* (1987), 117 Ill.2d 454, 478, the challenged classification, which was found to be "arbitrary and capricious," was between affiliated corporations filing consolidated federal returns and affiliated corporations filing separate returns. In *Federated Distributors, Inc. v. Johnson* (1988), 125 Ill.2d 1, the Uniformity Clause was found to have been violated by a classification which taxed certain low-alcohol beverages at a rate 8 times higher than "virtually identical" wine coolers. As a final example, in *National Pride of Chicago, Inc. v. City of Chicago*, 206 Ill.App.3d 1090 (1st Dist., 1990), the Appellate Court struck down a classification which treated self-service car washes differently than automatic car washes.

The court agrees with the Department that the classification between resident trusts and resident individuals is completely unlike the faulty classifications involved in

these cases and the court further agrees with the conclusion of the Department that "if trusts and individuals are not considered to have real and substantial differences, then it is difficult to imagine what taxpayers would have such differences in the Trust's view." *Defendants's Reply Brief*, at 23.

Based on these reasons, the court finds that the treatment afforded to resident trusts relative to the availability of credits for income tax paid to a source state does not violate the Uniformity Clause.

D) Oregon Trusts

The final issue pertains to the claim of the Oregon Trusts that they must be given credit for taxes paid to other states to offset their Illinois tax liability since it is now agreed that these trusts were not residents of Illinois.

The court respectfully disagrees with this contention. The Oregon Trusts, for tax years 1985 through 1987, filed their initial returns as residents. Subsequently, the Oregon Trusts filed amended returns, again as residents. It was not until 1995 before the administrative law judge hearing this matter that the Oregon Trusts initially made the claim that they, in fact, were not resident trusts. By this time, the three year statute of limitations for filing a claim for a refund of overpaid taxes had long since expired. 35 ILCS 5/911(a).

The court finds that the so-called "relation back" provision contained in §616(b) of the Code of Civil Procedure fails to provide an avenue of relief for the Oregon

Trusts under these circumstances. 735 ILCS 5/2-616(b). That provision is not without limitation, and the Oregon Trusts have failed to provide authority for the proposition that their late claim of non-residency may be considered to relate back to any claim made before the expiration of the statute of limitations. The court may not accept the proposition that their amended pleadings, which were filed within the applicable three year statute of limitations constituted their "original pleadings." Rather, the court agrees with the Department that the "original pleadings" for purposes of §616(b) were the protests filed by the Trusts and these were filed outside the period of limitation.

Finally, the court notes that the foreign tax credit under §601(b)(3) is available only to residents and that the Oregon Trusts may not use this provision to recoup taxes which were overpaid through taxpayer error.

CONCLUSION

For these reasons, the court finds the decision of the Department is neither contrary to the manifest weight of the evidence nor contrary to law and accordingly affirms the decision. Judgment is entered in favor of the defendants and against the plaintiffs.

JUDGE JOHN A. WARD
ENTER: APR 03 1998 Lm
John A. Ward
Circuit Court – 1537

Date: April 3, 1998

APPENDIX C

[SEAL]

Illinois Department of Revenue
OFFICE OF ADMINISTRATIVE HEARINGS
James R. Thompson Center
100 W. Randolph Street, Level 7-900
Chicago, Illinois 60601
(312) 814-3070

R.A. TRUSTS Nos. 1-25, OREGON TRUSTS Nos. 1-208, OREGON TRUST No. 9, WASHINGTON TRUSTS Nos. 1-176, A.N.P. TRUSTS Nos. 1-42, F.L.P. TRUSTS Nos. 10-17, 19-21, Taxpayers, v. THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	Case Nos. 91-IT-0025 91-IT-0066 92-IT-0279 91-IT-0094 91-IT-0095 93-IT-0103 CLAIMS FOR REFUND

NOTICE OF DECISION

To: Diane Anderson
Neal, Gerber & Eisenberg
Two North LaSalle Street
Chicago, Illinois 60602

Robert Asbille
Illinois Department of Revenue
100 West Randolph Street
Chicago, Illinois 60601

YOU ARE HEREBY NOTIFIED that the attached Order or Recommendation for Disposition of the Administrative Hearings Division in the above entitled cause has been adopted by the Director of Revenue as dispositive of the issues herein. Unless you otherwise request a rehearing pursuant to the provisions of Section 908(c) of the Illinois Income Tax Act, 35 ILCS 5/908(c), this determination shall become a final administrative decision 30 days from the date of issuance. Following expiration of the 30 days, or after issuance of a denial for rehearing, should one be requested, you may pursue your rights to administrative review by filing a complaint in the circuit court under the requirements of 735 ILCS 5/3-110 *et seq.*

11-18-96
Date of Decision

/s/ Ken Zehnder
Kenneth E. Zehnder,
Director
Illinois Department of Revenue

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

R.A. TRUSTS Nos. 1-25, OREGON TRUSTS Nos. 1-208, OREGON TRUST No. 9, WASHINGTON TRUSTS Nos. 1-176, A.N.P. TRUSTS Nos. 1-42, F.L.P. TRUSTS Nos. 10-17, 19-21,	)	Case Nos. 91-IT-0025 91-IT-0066 92-IT-0279 91-IT-0094 91-IT-0095 93-IT-0103
	)	CLAIMS FOR REFUND
Taxpayers,	)	John E. White,
v.	)	Administrative Law Judge
THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	

RECOMMENDED DISPOSITION REGARDING THE PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

Appearances: Diane Anderson, Neal, Gerber & Eisenberg, Chicago, Illinois, for Taxpayers. Robert Asbille, Special Assistant Attorney General, for Illinois Department of Revenue.

Synopsis:

The taxpayers in this case have collectively referred to themselves as "the Trusts" and each taxpayer shall be referred to as a "Trust" in this recommendation. Taxpayers filed amended Illinois income and replacement tax returns to claim refunds of income and replacement tax

paid during prior tax years. Taxpayers' claims requested refunds of the amount of foreign tax each trust paid to other states on income earned therein during the applicable tax years. The Department of Revenue ("Department") denied the trusts' claims. Taxpayers protested those denials, and requested hearings.

The parties subsequently filed cross motions for summary judgment. The parties stipulated to certain facts not in dispute. A summary of the undisputed facts material to the parties' motions are set forth below.

Facts Not In Dispute:

1. Pursuant to the parties' agreements and stipulations, the "years is issue" with respect to each trust are as follows:

R.A. Trusts Nos. 1-25	6/1/86	-	5/31/87
Washington Trusts Nos. 1-176	11/1/86	-	12/31/88
A.N.P. Trusts Nos. 1-42	10/1/86	-	12/31/88
Oregon Trusts Nos. 1-208	12/1/86	-	12/31/88
F.L.P. Trusts Nos. 10-17, 19-21	1/1/85	-	12/31/85

See Taxpayers' Cross-Motion for Summary Judgment ("Taxpayers' Motion"), Specter Affidavit, ¶ 5 (and Ex. No. 1 thereto); Agreed Order on Settled and Procedural Issues ("Agreed Order");[1] First Supplemental Stipulation of Facts

---

[1] The parties entered into an agreed order through which they settled some portions of the claims filed by the Washington Trusts and by the A.N.P. Trusts. *See* Agreed Order. The Department agreed to grant partial refunds for income tax paid by the Washington Trusts and by the A.N.P. Trusts regarding tax year 1988. Agreed Order, ¶¶ 3-6, 9. The settlement did not include the trusts' claims for partial refund of replacement tax paid for that tax year.

("Stip. 1"), ¶ 1; Second Supplemental Stipulation of Facts ("Stip. 2"), ¶ 1.

2. Each trust filed an original Illinois income tax return and an amended Illinois tax return for each tax year in issue. Taxpayers' Motion, ¶ 3; Department's Motion for Summary Judgment ("Department's Motion"), ¶¶ 2, 6.

3. Each amended return timely filed claimed a refund of a portion of Illinois income tax and personal property replacement tax each trust had paid regarding income earned outside Illinois. *See* Taxpayers' Motion, ¶ 4; Agreed Order, ¶ 9; Department Motion, ¶¶ 7-8. Each trust claimed a credit against its Illinois tax liability for the tax paid to another state on the same item of income. Taxpayers' Motion, ¶ 4; Department's Motion, ¶¶ 7-8.

4. The Department timely issued a Notice of Tentative Denial of Claim ("Notice of Denial") for each amended return filed by each trust, which Notices denied the entire amount of the refund claimed in each amended return. Each trust thereafter timely filed a protest and request for hearing. Taxpayers' Motion ¶ 5; Department's Motion. ¶¶ 10-11.

5. Each trust filed an original return for each year in issue as a resident of Illinois. Taxpayers' Motion, ¶ 10; Department's Motion, ¶ 2.

6. During each year in issue and the preceding year, each trust earned income from a state other than Illinois ("source state"). Taxpayers' Motion. ¶¶ 4, 7-8; Department's Motion, ¶ 3.

7. For each year in issue and the preceding year, each trust reported and paid income tax to the source state on the income earned or received

therefrom. Taxpayers' Motion, ¶¶ 7-8; Department's Motion, ¶ 3.

8. Consistent with section 301(a) of the Illinois Income Tax Act ("IITA"), each trust included the income earned outside Illinois in the "base income" it reported to Illinois on the original Illinois income tax return each trust filed for the years in issue. Taxpayers' Motion, ¶¶ 10-11; Department's Motion, ¶ 2.

9. The amended return each trust filed for each year in issue revised the original calculation of Illinois base income by adding back to the trust's federal taxable income the amount of the tax each paid to other states on income earned therefrom during a particular year. Each amended return then claimed a replacement tax credit and an income tax credit. Taxpayers' Motion, ¶ 14; Department's Motion, ¶¶ 6-8; Stip. 1, ¶ 6.

10. During each tax year in issue, all trustees of the trusts were individuals domiciled in Illinois, and the administration of the trusts occurred in Illinois. Stip. 1, ¶ 7.

11. All the trusts are residents of Illinois, except the Oregon Trusts. *See* Taxpayers' Motion, ¶¶ 6, 17. The parties do not dispute the Oregon Trusts status as non-residents of Illinois. *See* Department's Responsive Brief In Support Of Its Motion For Summary Judgment Motion ("Department's Reply"), pp. 2-3.

12. For the tax years at issue, no Oregon Trust ever filed an amended Illinois tax return on which it calculated base income as a non-resident of Illinois. *See* Taxpayers' Motion, ¶¶ 6, 10-11, 14; Department's Reply, p. 2.

13. On April 24, 1995, the Oregon Trusts filed a Motion For Leave To Amend Their Refund Claims And Protests to include the argument that they were not, in fact, residents of Illinois. *See* Oregon Trusts' Motion for Leave to Amend Their Refund Claims And Protests ("Oregon Trusts' Motion").

14. The Oregon Trusts' Motion was not accompanied by amended returns wherein taxpayers calculated base income as non-residents of Illinois. *See, id.* The Oregon Trusts' Motion was denied by order dated August 2, 1995.

15. The foreign tax credit each trust claimed on the amended returns each filed contradicted the instructions contained on Form IL-1041, Schedule CR, which instructions were in effect for all years in issue except calendar year 1988. Stip. 1, ¶ 6; Stip. 1, Ex. A, p. 12 (Instructions for Schedule CR).

16. On the federal tax returns each trust filed for the tax years at issue, each trust claimed a deduction for the tax each paid to another state in accordance with Section 164 of the Internal Revenue Code ("IRC"). *See* Taxpayers' Motion, ¶ 13; Department's Motion, ¶ 4.

17. The amount of the section 164 deduction each trust claimed on its federal return reduced its taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the IRC. *See* Taxpayers' Motion, ¶ 13; Department's Motion, ¶¶ 4-5.

Issues Presented:

The legal issue[2] presented by the parties' motions is whether the trusts are entitled to a partial refund for Illinois income tax and/or replacement tax measured by income which was earned outside Illinois, and which was taxed by other states. The parties agreed to treat their respective motions as cross-motions for partial summary judgment, in accordance with section 2-1005 of the Illinois Code of Civil Procedure. 735 **ILCS** 5/2-1005(d).

Conclusions of Law:

Before I address the respective parties' motions, I shall summarize the IITA's treatment of trusts as a distinct class of taxpayer. Section 306 of the IITA sets forth the general rule for allocating or apportioning the income of trusts and estates. Section 306 provides:

> Allocation or apportionment of income by estates and trusts. The items of income and deduction taken into account by an estate or trust in computing its base income for a taxable year shall be allocated or apportioned to this State to the extent provided by Sections 301 through 304 and, to the extent properly paid, credited or required to be distributed to beneficiaries for such taxable year, shall be deemed

---

[2] The parties agreed that a factual issue may exist regarding whether the amounts claimed to be refunded were mathematically correct, but only if I (or a court upon administrative review), conclude that some refunds are legally due.

to have been so paid, credited or distributed pro rata.

Ill. Rev. Stat. ch. 120, ¶¶ 3-306 (1987).

The IITA distinguishes between, and treats differently, resident trusts and non-resident trusts. Section 1501(a)(20) of the IITA defines the following trusts as residents:

(C) A trust created by a will of a decedent who at the time of his death was domiciled in this State; and

(D) An irrevocable trust, the grantor of which was domiciled in this State at the time such trust became irrevocable. For purposes of this subparagraph, a trust shall be considered irrevocable to the extent that the grantor is not treated as the owner thereof under Sections 671 through 678 of the Internal Revenue Code.

Ill. Rev. Stat. ch. 120, ¶¶ 5-1501(a)(20)(C), (D) (1987).

Section 301 of the IITA allocates to Illinois all items of income earned or received by a trust as a resident of Illinois, regardless of its source. Section 301 of the IITA provides, in part:

General Rule.

(a) Residents. All items of income or deduction which were taken into account in the computation of base income for the taxable year by a resident shall be allocated to this State.

(b) Part-year residents. All items of income or deduction which were taken into account in the computation of base income for the taxable year by a part-year resident shall, for that part of the

> year the part-year resident was a resident of this State, be allocated to this State and, for the remaining part of the year, be allocated to this State only to the extent provided by Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively).

Ill. Rev. Stat. ch. 120, ¶¶ 3-301 (1987).

In contrast, for a non-resident trust, Section 301(c) of the Act allocates to Illinois only those items of income or deduction referred to in Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively) which were taken into account when computing base income for the taxable year, and only to the extent provided by each such Section. Section 301(c) of the Act provides:

> (c) Other persons.
>
> (1) In General. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is referred to in Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively) shall be allocated to this State only to the extent provided by such Section.
>
> (2) Unspecified items. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is not otherwise allocated or apportioned pursuant to Section 302, 303 or 304 (including, without limitation, interest, dividends, items of income taken into account under the provisions of

> Sections 401 through 425 of the Internal Revenue Code, and benefit payments received by a beneficiary of a supplemental unemployment benefit trust which is referred to in Section 501(c)(17) of the Internal Revenue Code):
>
> > (A) In the case of an individual, trust or estate, shall not be allocated to this State; and
> >
> > (B) In the case of a corporation or a partnership, shall be allocated to this State if the taxpayer had its commercial domicile in this State at the time such item was paid, incurred or accrued.

Ill. Rev. Stat. ch. 120, ¶¶ 3-301 (1987). Subsections 301(c)(2)(A) and (B) treat non-resident individuals, trusts and estates different than non-residents having their commercial domicile in Illinois.

The IITA's different treatment of resident trusts and non-resident trusts is purposeful. Residency alone forms an independent basis for Illinois' imposition of income tax. Section 201 of the IITA provides, in part:

> Tax Imposed.
>
> (a) In general. A tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 **on the privilege of earning or receiving income in *or* as a resident of this State**. Such tax shall be in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

Ill. Rev. Stat. ch. 120, ¶ 2-201(a) (1987) (emphasis added). During the tax years at issue, the income tax imposed on individuals, trusts and estates was measured by an amount equal to 2 1/2% of net income (Ill. Rev. Stat. ch. 120, ¶ 2-201(b)(1)), while the income tax imposed on corporations was measured by an amount equal to 4% of net income (Ill. Rev. Stat. ch. 120, ¶ 2-201(b)(2)).

Section 201(c) of the IITA also imposes a Personal Property Replacement Income Tax on every corporation, partnership and trust. Individuals are not subject to the Personal Property Replacement Income Tax. Section 201(c) provides:

> (c) Beginning on July 1, 1979 and thereafter, in addition to such income tax, there is also hereby imposed the Personal Property Replacement Income Tax measured by net income on every corporation (including Subchapter S corporations), partnership and trust, for each taxable year ending after June 30, 1979. Such taxes are imposed on the privilege of earning or receiving income in or as a resident of the State. The Personal Property Replacement Income Tax shall be in addition to the income tax imposed by subsections (a) and (b) of this State or by any municipal corporation or political subdivision thereof.

Ill. Rev. Stat. ch. 120, ¶ 2-201(c) (1987). The only credit against Personal Property Replacement Income Tax liability is set forth in section 201(e) of the Act. That section grants a credit for investment in qualified property. *See* Ill. Rev. Stat. ch. 120, ¶ 2-201(e) (1987); *see also*, Illinois Income Tax Form IL-1041, Schedule CR (rev. 12/86) (the instructions to an Illinois resident trusts' form IL-1041

Schedule CR contains the following notice in italicized type, "NOTE: Do not claim [foreign tax] credit against any replacement tax amounts.") (a copy of the instructions is contained on pp. 11-12 of Ex. A to the parties' Stip. 1).

Effective August 24, 1988, the Illinois General Assembly amended section 203(c) of the IITA, which details how trusts and estates are required to calculate base income for Illinois income tax purposes. As amended, section 203(c) provided, in part:

> § 203. Base income defined.
>
> * * *
>
> (c) Trusts and estates.
>
> (1) In general. In the case of a trust or estate, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).
>
> (2) Modifications. Subject to the provisions of paragraph (3), the taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:
>
> * * *
>
> (F) **For taxable years ending on or after January 1, 1989,** an amount equal to the tax deducted pursuant to Section 164 of the Internal Revenue Code if the trust or estate is claiming the same tax for purposes of the Illinois foreign tax credit under section 601 of this Act; and

* * *

and by deducting from the total so obtained the sum of the following amounts:

* * *

(K) An amount equal to all amounts included in taxable income as modified by subparagraphs (A), (B), (C), (D), (E), (F) and (G) which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States;

Ill. Rev. Stat. ch. 120, ¶ 2-203 (1989) (*as amended by* P.A. 85-1200) (*now* 35 ILCS 5/203(c) (1994)) (emphasis added).

Public Act 85-1200 substantively changed the law by granting to an Illinois resident trust the ability to take a foreign tax credit against Illinois income tax due where the trust had already taken a section 164 deduction, and thereby reduced its federal taxable income. For tax years ending prior to January 1, 1989, section 601 of the IITA precluded resident trusts from taking an Illinois foreign tax credit under the same circumstances (*see* Ill. Rev. Stat. ch. 120, ¶ 6-601(b)(3)), and section 203(h) of the IITA prohibited any taxpayer from modifying, on their own, federal taxable income by adding back the amount of the section 164 deduction previously taken. Ill. Rev. Stat. ch. 120, ¶ 2-203(h).

Throughout the tax years at issue, section 601 of the IITA provided, in part:

§ 601. Payment on Due Date of Return.

* * *

(b) Amount payable. In making payment as provided in this section there shall remain payable only the balance of such tax remaining due after giving effect to the following:

* * *

(3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. . . . For purposes of this subsection, no compensation received by a resident which qualifies as compensation paid in this State as determined under Section 304(a)(2)(B) shall be considered income subject to tax by another state or states. **The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year.**

Ill. Rev. Stat. ch. 120, ¶ 6-601. (emphasis added)

A trust claims an Illinois foreign tax credit by filing form Schedule CR with its form IL-1041. During the tax years at issue, the instructions for form IL-1041, Schedule CR provided, in pertinent part:

> Illinois residents may claim a credit against their Illinois income tax for out-of-state income taxes reported and paid on the same income to

another taxing jurisdiction (out-of-state city, out-of-state county, other state, or foreign country). **The credit may be claimed if:**

1. **In computing your federal taxable income,** which appears on line 1 of your IL-1041, **you did not deduct any income taxes paid to another taxing jurisdiction on U.S. 1041, line 11.**

2. The tax paid to another taxing jurisdiction, for which you are claiming the credit, is an income tax or tax measured by income for the same taxable year. You may not claim credit for the Michigan Single Business Tax.

3. The income subject to tax in another jurisdiction is included in the amount shown as Illinois income (line 5 of your IL-1041, Part I).

4. You attach a copy of the tax return you filed in the other taxing jurisdiction or a copy of any statement or statements (including U.S. 1116 and Schedule A, Form 1116, if completed) indicating payment of the foreign tax for which a credit is claimed. A wage and tax statement is sufficient only where a city or county imposes an earnings tax and requires no return. If you're a member of a partnership that pays taxes for you in another taxing jurisdiction, the statement furnished to you by the partnership indicating such payment must identify the partnership.

The credit cannot be allowed:

1. **For any income that is taxed by another taxing jurisdiction but not by Illinois.**

2. For more than the total amount of income, even though the same income may have been

taxed by both a city and a state. (See the example in the instructions for line A, column II.)

3. **If you took a deduction on U.S. 1041, line 11.**

NOTE: If you have amounts on line 11, U.S. 1041 and are claiming amounts on Schedule CR, column III that are still included in federal taxable income (IL-1041, line 1), please provide a detailed breakdown of amounts on line 11, U.S. 1041.

NOTE also that you will not qualify for a tax credit on your Schedule CR, even if you add back your U.S. 1041, line 11 deduction.

Instructions for IL-1041, Schedule CR (rev. 12/86), Stip. 1, Ex. A, p. 12 (of exhibit) (emphasis added).

Taxpayers' Motion Regarding the Oregon Trusts

Summary judgment is appropriate where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c) (1994). I will address each motion separately.

Shortly after they filed their cross-motion for summary judgment, the Oregon Trusts also filed a Motion for Leave to Amend Their Refund Claims And Protests to include the argument that the Oregon Trusts were not, in fact, residents of Illinois. The Oregon Trusts expressly stated in their Motion that they were not seeking refund of more than the amounts identified in their amended

returns they filed. Oregon Trusts' Motion, ¶ 4. The Oregon Trusts asserted, in substance,[3] that their non-resident status was just another reason why the Department lacked the power to deny their claims for the refund of the amounts of foreign tax paid on income earned outside Illinois. *See* Oregon Trusts' Motion, ¶ 2. The Department does not dispute the Oregon Trusts' non-resident status. Department's Reply. pp. 2-3. It merely argues that the trusts failed to raise the issue of non-residency within the statute of limitations applicable to claims under the IITA.

---

[3] The Oregon Trusts specifically argued that their "nonresident status . . . is further proof that the proposed Illinois tax on their out-of-state income is invalid. This issue is substantially similar to the issue of whether the trusts are entitled to a credit which would reduce the Illinois tax on their non-Illinois income." Oregon Trusts' Motion, ¶ 2.

No tax, however, is being proposed in these matters. Instead, the Oregon Trusts are claiming credits against tax they previously self-assessed and paid as residents of Illinois. As filed, the amended returns claimed credits for foreign tax paid on income the trusts asserted (at the time the amended returns were filed) was also subject to Illinois income tax. Taxpayers' Motion, ¶ 4. Now, the trusts claim the income on which foreign tax was paid was not subject to Illinois tax, because they were not Illinois residents. Once it was actually notified of the Oregon Trusts' non-resident status, the Department defended its denial of the trusts' claims by arguing that the claims must be denied because the trusts never filed the appropriate amended returns within the period set by statute. That argument is distinct from the argument that Illinois income tax is properly assessed on 100% of the non-resident Oregon Trusts' income.

The issues are not substantially similar because the foreign tax credit is not the appropriate remedy for taxpayers' mistaken calculation of base income allocable to Illinois.

See Department's Brief In Support Of Its Motion For Summary Judgment ("Department's Memo"), pp. 6-7.

The IITA requires non-resident trusts that earn income in Illinois to file returns and to allocate to Illinois "[a]ny item of income or deduction . . . taken into account in the computation of base income for the taxable year . . . which is referred to in Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively) . . . to the extent provided by such Section." Ill. Rev. Stat. ch. 120, ¶ 3-301(c)(1). The trusts acknowledge that some of the income allocated to Illinois on their original Illinois income and replacement tax returns was, in fact, earned from Illinois sources. Stip. 1, ¶ 9.

As non-residents, any Illinois income tax the Oregon Trusts paid to Illinois which was measured by income not properly allocable to Illinois would have been subject to a credit or refund if the trusts had filed, within the period prescribed by statute, amended returns as non-residents (i.e., returns on which they properly apportioned income pursuant to IITA §§ 302-304). *See* Ill. Rev. Stat. ch. 120, ¶¶ 9-909, 9-911. A taxpayer has an affirmative duty to file a claim for a tax refund within a prescribed period of time. *Dow Chemical v. Department of Revenue*, 224 Ill. App. 3d 263 (1st Dist. 1991); Ill. Rev. Stat. ch. 120, ¶ 9-911(a) (1985) (*now* 35 ILCS 5/911(a)). Section 911(a) of the IITA sets forth the period during which taxpayers must file claims to request refunds of taxes allegedly overpaid, and provides:

> (1) A claim for refund shall be filed not later than three years after the date the return was

> filed . . . or one year after the date the tax was paid, whichever is the later; and
>
> (2) No credit or refund shall be allowed or made with respect to the year for which the claim was filed unless such claim is filed within such period.

Ill. Rev. Stat. ch. 120, ¶ 9-911(a) (1987).

The tax years at issue are the trusts' fiscal years 1985 through 1988. *See* Taxpayers' Motion, Specter Affidavit, ¶ 5 (and Ex. No. 1 thereto); Agreed Order; Stip. 1, ¶ 1; Stip. 2, ¶ 1. The first time the Oregon Trusts notified the Department that they were non-residents was January 17, 1995, when the trusts filed their Cross-Motion for Summary Judgment (*see* Taxpayers' Motion, p. 1 (first page of Taxpayers' Motion date stamped)), a date well beyond the statutory period for amending their original returns. Even after the Oregon Trusts finally asserted non-resident status, they never bothered to file amended returns to apportion income as non-residents. Because the Oregon Trusts never filed the required amended returns, summary judgment cannot be entered for them.

Additionally, and even if the Oregon Trusts had (1) filed amended returns calculating base income allocable to Illinois as non-residents, (2) within the statutory period, (3) on which they made claims for refund based on foreign tax paid – none of which, in fact, happened – the plain text of section 601(b)(3) directs that the foreign tax credit is available to residents only. The first sentence of section 601(b)(3) provides:

> The aggregate amount of tax which is imposed upon or measured by income **and which is paid by a resident** for a taxable year to another state

> or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year.

Ill. Rev. Stat. ch. 120, ¶ 6-601(b)(3) (emphasis added). The Department opposed the Oregon Trusts' Motion by arguing that the text of § 601(b)(3) limited the applicability of a credit to residents only. *See* Department's Memo, p. 7; Department's Reply, p. 26. Without offering any support, the trusts argued that the Department's argument was incorrect. Taxpayers' Memo, p. 6. The trusts, however, fail to present any cogent reason why the first sentence of section 601(b)(3) should be understood to mean something different than what it plainly says.

Nor is the Oregon Trusts' argument (that non-residents are entitled to a § 601(b)(3) credit) logically consistent with the statutory scheme set up to apportion the base income of non-residents. If a non-resident followed the directions of §§ 302-304 when allocating to Illinois that portion of income against which Illinois income tax would be measured, it would not ordinarily include income earned or received outside Illinois when calculating Illinois taxable base income. Ill. Rev. Stat. ch. 120, ¶¶ 3-301(c)(1), 302, 303, 304. The Oregon Trusts themselves acknowledge that fact. Taxpayers' Motion, ¶¶ 27-28; *see also*, Taxpayers' Combined Memorandum In Support Of Their Cross-Motion For Summary Judgment And Against The Department's Motion For Summary Judgment ("Taxpayers' Memo"), p. 6; Taxpayers' Combined Reply Memorandum In Support Of Their Cross-

Motion For Summary Judgment And Against The Department's Motion For Summary Judgment ("Taxpayers' Reply"), p. 23. There is simply no need for the Illinois legislature to have provided non-residents with a credit for foreign tax paid on income never intended to be subject to Illinois income tax in the first place. *See, e.g.*, Stip. 1, Ex. A (Instructions for Schedule CR), p. 12 ("The credit cannot be allowed . . . [f]or any income that is taxed by another taxing jurisdiction but not by Illinois").

Summary judgment cannot be entered for the Oregon Trusts on the basis that they were non-residents because they never filed amended returns on which they calculated base income as non-residents within the period set by statute. Moreover, under the express language of section 601(b)(3), foreign tax paid by non-resident Illinois taxpayers is not creditable against the non-resident's Illinois income tax liability.

Taxpayers' Motion Regarding the Resident Trusts Statutory Interpretation

Taxpayers first argue that Public Act 85-1200 should be understood as a clarification of existing law. *See* Taxpayers' Reply, p. 5. Public Act 85-1200 created a entirely new addition modification which allowed resident trusts to add back the amount of the section 164 foreign tax deduction the trusts had previously elected[4] to take in

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[4] Taxpayers' assertion, that under section 461 (a) of the Code, a taxpayer cannot elect to take or forego a federal deduction, stretches the limits of credibility. *See* Taxpayers' Memo, pp. 9, 12 n.1. Section 461 of the Code is situated within a section of the Code titled, "Methods of Accounting", and provides:

order to reduce their federal taxable income. Until that amendment took effect, Illinois resident trusts had a choice to make. They could either elect to take the section 164 deduction when calculating federal taxable income, and thereafter be precluded from taking an Illinois foreign tax credit of the same amount as the deduction. Or, they could elect not to take the § 164 deduction at the federal level, and take a creditable amount "off the top" of their Illinois income tax due. In effect, the new addition modification created by P.A. 85-1200 granted resident trusts the statutory authority to pretend that they did not take a section 164 deduction when calculating federal taxable income. The legislature granted such authority, however, only "[f]or taxable years ending on or after January 1, 1989".

A material change in the language of an unambiguous statute creates a presumption that the amendment was intended to change the law. *Secretary of State v. Mikusch*, 138 Ill. 2d 242, 252 (1990). While the trusts have argued that the amendment should be given retroactive application, they have not asserted that section 203 was ambiguous prior to amendment. Section 203 certainly

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§ 461. General rule for taxable year of deduction.

(a) General rule.

The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

IRC § 461. Read in context, § 461(a) does not compel a taxpayer to take any and all deductions to which it might be allowed, it merely compels taxpayers to take deductions or credits *during the proper taxable year* if they are taken.

expresses the legislature's unambiguous intent to prohibit any extra legislative creation of "modifications . . . on the amount of income, gain, loss or deduction taken into account in determining . . . taxable income . . . ", such as the trusts' unilateral addition modifications made in these matters. Ill. Rev. Stat. ch. 120, ¶ 2-203(h) (*now* 35 ILCS 5/203(h)).

Nor have the trusts pointed to any legislative history suggesting that the legislature intended to clarify, rather than change, existing law through P.A. 85-1200. The Illinois Supreme Court has indicated such evidence is necessary to rebut the presumption that an amendment to an unambiguous statutory provision was intended to change the law. *Secretary of State v. Mikusch*, 138 Ill. 2d at 252.[5]

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[5] Instead, counsel for taxpayers quoted the Official Commentary on the Illinois Income Tax Act, to support the argument that "[t]he Department's denial of a tax credit to a resident trust conflicts with the legislative intent regarding the Section 601(b)(3) credit." Taxpayers' Memo, pp. 10-11.

The Official Commentary, however, suggests that the foreign tax credit was originally intended to eliminate potential double taxation of a resident's *compensation* received from out of state sources. Compensation is a distinct form of income, and is statutorily defined as "wages, salaries, commissions and any other form of remuneration paid to employees for personal services." Ill. Rev. Stat. ch. 120, ¶ 15-1501(3) (1987) (*now* 35 ILCS 5/501(3)). Ordinarily, individuals, and not trusts, would receive income as compensation. The trusts have specifically averred that the out-of state income they received was not compensation. *See* Taxpayers' Motion, ¶ 33, Ex. A (Spector Affidavit), ¶ 21.

Despite the intent stated in the Official Commentary, when written, the foreign tax credit provision was not limited to credit foreign tax paid on items of compensation. Instead, the credit

The language of P.A. 85-1200 is unambiguous, as is that of its predecessor. The amendment substantively changed existing law. Therefore, I will not enter summary judgment for taxpayers on their argument that P.A. 85-1200 merely clarified existing law.

Constitutional Arguments

The remaining arguments presented by the trusts involve their assertion that the Department's denial of a foreign tax credit for tax paid to other states on income earned outside Illinois is unconstitutional. It is unconstitutional, the trusts claim, because it constitutes double taxation. *See* Taxpayer's Memo, p. 14. Specifically, the trusts argue that double taxation violates the uniformity clause of the Illinois Constitution, as well as the Due Process and Commerce Clauses of the United States Constitutions. *See, e.g.*, Taxpayers' Reply, pp. 2-3. The trusts' Commerce Clause challenge is predicated on their argument that Illinois cannot tax income already taxed by the state where it was earned in a manner that would violate the rule announced in *Complete Auto v. Brady*, 430 U.S. 274 (1977). *See* Tr. p. 30. The trusts assert that if the refunds claimed are not allowed, the IITA must be found unconstitutional. Tr. p. 33; Taxpayers' Reply, p. 3.

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was made available to all items of income, but only if the resident taxpayer had not already deducted the foreign tax when determining the amount of base income taxable by Illinois. Under the provision as written, both resident trusts and individuals could take advantage of the credit, but neither could achieve realize a double deduction when calculating *Illinois* taxable income.

Article IX, section 2 of the Illinois Constitution provides:

> In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

Ill. Const. 1970, art. IX, § 2. The Illinois Constitution's uniformity clause was intended to encompass the equal protection clause and add to it even more limitations on government. If a tax passes muster under the uniformity clause, it inherently fulfills the requirement of the equal protection clause. *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill. 2d 239, 247 (*citing Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill. 2d 454, 468 (1987)).

Statutes are presumed constitutional, and broad latitude is afforded to legislative classifications. *See, e.g., Geja's Cafe*, 153 Ill. 2d at 248. A tax classification is valid under the uniformity clause if it is based on a real and substantial difference between the persons taxed and those not taxed, and if the classification bears some reasonable relationship to the object of the legislation or to public policy. The party challenging a classification on uniformity grounds has the burden of showing that the classification is arbitrary or unreasonable. *Id.*

Taxpayer trusts base their claims on two different classifications. The first classification is between residents and non-residents. The trusts complain that no reasonable bases exist for Illinois to treat resident trusts differently than the way non-residents such as corporations

and partnerships are treated, for purposes of granting the § 601 foreign tax credit.

I find no support for taxpayers' resident/non-resident classification complaint. There are real and substantial differences between residents and non-residents for purposes of taxation. That fundamental classification is based on a state's constitutionally limited (by principals of due process, equal protection and interstate commerce) power to tax only that portion of a non-resident's income that fairly reflects the non-resident's activities in the taxing state. *See, e.g., Oklahoma Tax Commission v. Chickasaw Nation*, 115 S. Ct. 2214, 2222-23 & nn. 11-12 (1995).

The IITA does not impose a tax directly on income. Instead, it imposes a "tax measured by net income . . . on every individual, corporation, trust and estate . . . on the privilege of *earning or receiving income in or as a resident of [Illinois]*. . . . " Ill. Rev. Stat. ch. 120, ¶ 2-201(a) (*now* 35 **ILCS** 5/201(a)). In the case of non-residents, tax is imposed upon the privilege of earning or receiving income *in* Illinois. In the case of residents, tax is imposed upon the privilege of earning or receiving income *as a resident of* Illinois. In this case, tax was self-assessed and paid based on the privilege of earning or receiving income as residents of Illinois. *See* Taxpayers' Reply, p. 2 (Preliminary Observations).

The United States Supreme Court has long acknowledged that residency alone provides the basis for state taxation of all of a resident's income, from whatever source. *New York ex-rel. Cohn v. Graves*, 300 U.S. 308 (1937). Taxpayers argue that *Cohn* is inapposite to these matters because, in *Cohn*, there was no actual double

taxation of the resident's income by both taxpayer's state of residence and the state in which taxpayer earned a portion of the income. *See* Taxpayers' Reply, pp. 17-20. Taxpayers' ability to distinguish the facts of the matters, however, does not nullify the continued validity of *Cohn's* ruling.

In *Oklahoma Tax Commission v. Chickasaw Nation*, the United States Supreme Court recently reaffirmed *Cohn's* ruling that a state "may tax *all* the income of its residents, even income earned outside the taxing jurisdiction". 115 S.Ct. 2214, 2222 (1995) (*citing to and quoting Cohn*, 300 U.S. 308, 312-13, 57 S.Ct. 466, 467-68, 81 L.Ed. 666 (1937)) (emphasis original). The Court distinguished a state's authority to tax the income of its residents with its significantly diminished authority to tax the income of non-residents. *Oklahoma Tax Commission v. Chickasaw Nation*, 115 S.Ct. at 2222 n.11 ("For non-residents, in contrast, jurisdictions generally may tax only income earned within the jurisdiction."). The Court called *Cohn's* ruling "a well established principle of interstate and international taxation . . . [which] has international acceptance." *Id.*, at 2222.

After documenting just how well recognized *Cohn's* ruling was, the Court dismissed the notion that a state is constitutionally precluded from taxing all of its resident's income where another jurisdiction also imposed tax on income the resident earned outside the state of residence. The Court wrote:

> Although sovereigns have authority to tax all income of their residents, including income earned outside their borders, they sometimes elect not to do so, and they commonly credit

> income taxes paid to other sovereigns. But "[i]f foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and not one compelled by jurisdictional considerations." [citation omitted]

Oklahoma Tax Commission v. Chickasaw Nation, 115 S.Ct. at 2223 n. 12. I therefore reject taxpayers' arguments that the United States Constitution requires Illinois to grant them a credit for foreign tax paid. *See* Taxpayers' Reply, p. 11. Both the *Cohn* and *Oklahoma Tax Commission* decisions support Illinois' constitutional authority to tax all the resident trusts' income, even income previously taxed in the states in which it was earned.

Most importantly, Illinois has a statutory scheme by which the trusts could have avoided what it refers to as "double taxation." The trusts, however, elected not to take advantage of Illinois' foreign tax credit, at least not as written. In *Illinois Gasoline Dealers Ass'n. v. Chicago*, 119 Ill. 2d 391, 402 (1988), the Illinois Supreme Court rejected a taxpayer's contention that "uniformity of taxation is violated by double taxation." 119 Ill. 2d at 402. There, the Court reiterated its prior ruling that "there is no constitutional restraint against more than one privilege or excise tax where the total does not exceed reasonable taxation for the privilege enjoyed." *Id.* (*citing People v. Deep Rock Oil Corp.*, 343 Ill. 388 (1931)). The Department's denial of taxpayers' claims does not violate the United States Constitution's Fourteenth Amendment because the "Fourteenth Amendment no more forbids double taxation than it does doubling the amount of a tax". *Illinois Central Rail Co. v. Minnesota*, 309 U.S. 157, 164, 60 S.Ct. 419, 423 (1940) (*quoting* Justice Holmes in *Ft. Smith Lumber Co. v. Arkansas*

ex rel. Arbuckle, 251 U.S. 532, 533, 40 S.Ct. 304, 305, 64 L.Ed. 396).

The resident trusts next complain that the Department's denial of their claims violates the uniformity clause of the Illinois constitution because resident individuals were able to claim credit for foreign tax paid on income earned outside Illinois when taking the section 164 deduction. *See* Tr. pp. 33-34. The trusts argue that there is no reasonable basis for the Department to deny resident trusts the Illinois foreign tax credit and grant resident individuals the same credit when both took a section 164 deduction on the federal returns. *See* Tr. p. 34.

While, at first blush, it might seem unfair for resident individuals to have been able to take the § 164 deduction and claim an Illinois foreign tax credit, while resident trusts could not claim a foreign tax credit when taking the § 164 deduction, a reasonable basis for the distinct treatment exists. The reason was due to the different way the section 164 deduction was, and is, taken by trusts versus individuals for federal filing purposes under the IRC. Trusts take the section 164 deduction "above the line", i.e., *before* federal taxable income is determined, whereas individuals take the deduction "below the line", i.e., *after* federal adjusted gross income is determined. Under the IITA, federal taxable income is the starting point for determining a trust's Illinois base income, and adjusted gross income is the starting point for determining an individual's Illinois base income. So, while both residents would ordinarily take advantage of the § 164 deduction, individuals would not have deducted the amount of foreign taxes paid when determining federal adjusted gross income, and therefore, Illinois base income.

I presume the legislature was aware that individuals took the § 164 deduction after determining adjusted gross income, while trusts took the deduction when determining federal taxable income. *See* [Illinois] State Tax Rep., (CCH) ¶ 14-005 (1987) (Official Commentary on the Illinois Income Tax Act ("Official Commentary") (the legislature identified state income tax as a " 'page 2 deduction' for federal tax purposes (i.e., a deduction to be taken *from* adjusted gross income rather than one taken in arriving at adjusted gross income)."). Section 601(b)(3)'s direction that "[t]he credit . . . shall not be allowed if any creditable tax was deducted in determining base income for the taxable year", must be read as the legislature's way of avoiding the double deduction[6] resident trusts would receive without it.

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[6] The double deduction would take effect in the following manner: The first deduction would occur when the resident trusts deducted the amount of foreign tax paid when determining federal taxable income. Because federal taxable income is the starting point for calculating Illinois base income, any deduction taken when determining federal taxable income is also deducted when determining Illinois base income. The Illinois income tax liability would then be measured by multiplying the Illinois tax rate by the amount of Illinois base income. Finally, the second deduction would take effect when the amount of foreign tax paid (and already deducted when determining base income) would be subtracted from, i.e., "taken off the top of", Illinois tax due.

The trusts have argued that they will not receive a double benefit if the foreign tax credits are allowed because "it is undisputed that the trusts have added back their federal income deduction for the Source State Tax." Taxpayers' Reply, p. 4. What the Department specifically disputed was the propriety of that addition modification. *See* Department's Memo, pp. 3-4.

The IITA's prior statutory scheme of providing a foreign tax credit to both resident trusts and resident individuals, albeit not under identical circumstances, was, therefore, not arbitrary or unreasonable. The Illinois Supreme Court has previously identified real and substantial differences between individuals and trusts for taxation purposes (*see Hanley v. Kusper*, 61 Ill. 2d 452 (1975)), and trusts and individuals are, in fact, treated differently under various provisions of the IITA. *See infra, e.g.*, pp. 5-9. Reasonable people might well question the policies underlying the legislature's decision to amend the IITA to create a foreign tax credit scheme that arguably treats the accumulated income of resident trusts better than the wages earned by resident individuals, but one should not dispute the legislature's underlying authority to make such a decision in the first place. That policy decision was one the Illinois legislature was wholly entitled, but not constitutionally required, to make. *See Oklahoma Tax Commission v. Chickasaw Nation*, 115 S. Ct. at 2223 n. 12.

I find no unreasonable or arbitrary classification in the IITA prior to P.A. 85-1200 that violates the Illinois

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The Department informed taxpayers of the exclusive means by which the creditable amount of foreign tax paid could have been added back (i.e., by filing amended federal returns to add back the § 164 deduction previously taken) in each Notice of Denial, and the Department specifically identified and asserted the IITA's statutory prohibition against creating modifications (like the one to which taxpayers claim a constitutional right) other than those expressed in the language of the Act.

Constitution's uniformity clause.[7] I conclude that the Department's denial of the trusts' claims does not violate either the Illinois or the United States Constitution's Fourteenth Amendments' due process or equal protection clauses.

Commerce Clause

The trusts argue that *Complete Auto Transit v. Brady* sets the standard against which a state's power to tax its resident's income must be measured. In *Complete Auto,* the United States Supreme Court reiterated its prior recognition of a State's right to tax "the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce." *Complete Auto,* 430 U.S. at 280 (*citing* Justice Frankfurter's opinion in *Freeman v. Hewit,* 329 U.S. 249, 255 (1946)). *Complete Auto* involved a commerce clause challenge to Mississippi's authority to impose an excise tax on a non-resident's corporation's right to engage in the business of providing interstate transportation services within the taxing State. At oral argument, counsel for taxpayers could cite no support for its argument that *Complete Auto's* internal consistency test is applicable to a

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[7] Taxpayers have not pleaded any facts showing they suffered discrimination based on the accounting method they used when determining their Illinois tax liabilities. *Compare* Taxpayers' Motion, p. (Count IV facts alleged) *with* Taxpayers' Memo, pp. 18-19 (Timing Differences Among Resident Trusts). Therefore, I have not addressed the hypothetical argument set forth in their memo.

State's imposition of income tax on all of a resident's income. *See* Tr. p. 46.

I do agree, however, with taxpayers' counsel's oral argument summation on this issue: "in conclusion, all the legal [commerce clause] arguments boil down to the issue of whether *Complete Auto* applies here or whether there is something special about being a resident that means it doesn't apply." Tr. p. 48. Both the United States Supreme Court and the Illinois Supreme Court have agreed that "[i]t is not the purpose of the Commerce Clause to protect state residents from their own state taxes." *Geja's Cafe*, 153 Ill. 2d at 256 (*quoting Goldberg v. Sweet*, 488 U.S. 252, 266 (1989)). Residency matters. Therefore, I find the trusts' commerce clause arguments irrelevant to this dispute.

Replacement Tax

Section 601(b)(3) provides a credit for:

> The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act. . . .

Ill. Rev. Stat. ch. 120, ¶ 6-601(b)(3). The replacement tax is imposed by section 201(c) of the IITA.

The foreign tax credit:

> shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year.

Ill. Rev. Stat. ch. 120, ¶ 6-601(b)(3). Thus, by its express terms, § 601(b)(3) does not provide a credit against Illinois' replacement tax. The instructions for the foreign tax credit form, moreover, stated: "NOTE: Do not claim [foreign tax] credit against any replacement tax amounts." *See* Stip. 1, Ex. A, p. 12.

I cannot grant summary judgment for the trusts because the foreign tax they paid is not creditable against their Illinois replacement tax liability.

The Department's Motion

The Department argues that, as residents of Illinois, all of the trusts' income, even the income earned through activities conducted outside Illinois, was subject to Illinois income and replacement tax. The Department argues that taxpayers are not entitled to the refunds because the foreign tax credit, like other deductions from tax, is a matter of legislative grace. The IITA's foreign tax credit provision provided that if the foreign tax was deducted when determining Illinois base income, the credit was not available. Because the trusts elected to reduce their federal taxable income by taking the federal deduction pursuant to IRC § 164, they deducted the tax when determining Illinois base income, and they are not entitled to the foreign tax credits claimed.

The trusts may not voluntarily add-back the amount of tax deducted from federal taxable income because such unilateral modifications are statutorily proscribed, and because the legislature clearly expressed its intent that

P.A. 85-1200 be applied prospectively only. The Department argues that, as a matter of law, the trusts may not obtain the refunds claimed. I agree.

The trusts could have claimed a credit for taxes imposed or measured by income and paid to another state, had they not first deducted the amounts of foreign tax paid when calculating federal taxable income. Alternatively, had the trusts amended their federal tax returns to actually add back the amount of the § 164 deduction to their federal taxable income, the trusts could have thereafter filed amended Illinois income and replacement tax returns to claim the IITA's § 601 foreign tax credit, based on those federal changes. The trusts did neither. Instead, by taking the unauthorized addition modification, taxpayers have merely pretended that they did not take the § 164 deduction on their federal returns. The trusts' voluntary addition modifications contradicted the plain language of § 2-203(h) of the IITA and were, therefore, unauthorized by law.

I find the legal issue in these matters substantially similar to an argument dismissed by the Illinois Supreme Court in *Caterpillar Tractor Co. v. Lenkos*, 84 Ill. 2d 102, 127-28 (1981). In that case, the Illinois Supreme Court cited to § 203(g) (*subsequently recodified as* § 2-203(h)) of the IITA to support its ruling that taxpayers have "a right only to deductions specifically authorized under the [IITA]." *Id.*, at 127. Here, taxpayers have no right to modify their base income in a manner specifically prohibited by statute for the tax years at issue. Ill. Rev. Stat. ch. 120, ¶ 203(h).

Section 601 of the IITA provides the statutory bases for determining whether the foreign taxes the trusts paid are creditable against the trusts' Illinois income tax liability. Section 601 (b)(3) provides that the foreign tax credit "shall not be allowed if any creditable tax was deducted in determining base income for the taxable year." Ill. Rev. Stat. ch. 120, ¶ 601(b)(3). Because taxpayers elected to take the § 164 deduction when determining their federal taxable income, they are not entitled to a refund of foreign tax paid.

Finally, and as I previously concluded (*see, infra*, pp. 23-24), section 601(b)(3)'s foreign tax credit is not creditable against a resident's replacement tax liability. I conclude that the Department properly denied all refunds claimed by taxpayers' amended returns. Therefore, I recommend that summary judgment be entered for the Department.

9/30/96
Date

/s/ John E. White
Administrative Law Judge

APPENDIX D

Relevant Provisions of the Illinois Income Tax Act, 35 ILCS 5/101 *et seq.*

35 ILCS 5/201 Tax Imposed

(a) In general. A tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or receiving income in or as a resident of this State. Such tax shall be in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

(b) Rates. The tax imposed by subsection (a) of this Section shall be determined as follows:

* * *

(3) In the case of an individual, trust or estate, for taxable years beginning after June 30, 1989, an amount equal to 3% of the taxpayer's net income for the taxable year.

* * *

(c) Beginning on July 1, 1979 and thereafter, in addition to such income tax, there is also hereby imposed the Personal Property Tax Replacement Income Tax measured by net income on every corporation (including Subchapter S corporations), partnership and trust, for each taxable year ending after June 30, 1979. Such taxes are imposed on the privilege of earning or receiving income in or as a resident of this State. The Personal Property Tax Replacement Income Tax shall be in addition to the income tax imposed by subsections (a) and (b) of this

Section and in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

(d) Additional Personal Property Tax Replacement Income Tax Rates. The personal property tax replacement income tax imposed by this subsection and subsection (c) of this Section in the case of a corporation, other than a Subchapter S corporation and except as adjusted by subsection shall be an additional amount equal to 2.85% of such taxpayer's net income for the taxable year, except that beginning on January 1, 1981, and thereafter, the rate of 2.85% specified in this subsection shall be reduced to 2.5%, and in the case of a partnership, trust or a Subchapter S corporation shall be an additional amount equal to 1.5% of such taxpayer's net income for the taxable year.

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35 ILCS 5/203 Base income defined

* * *

(c) Trusts and estates.

(1) In general. In the case of a trust or estate, base income means an amount equal to the taxpayer's [federal] taxable income for the taxable year as modified by paragraph (2).

(2) Modifications. Subject to the provisions of paragraph (3), the taxable income referred to in paragraph (1)

shall be modified by adding thereto the sum of the following amounts:

* * *

(F) For taxable years ending on or after January 1, 1989, an amount equal to the tax deducted pursuant to Section 164 of the Internal Revenue Code [26 U.S.C. § 164] if the trust or estate is claiming the same tax for purposes of the Illinois foreign tax credit under Section 601 of this Act [35 ILCS 5/601]; and

* * *

(h) Legislative intention. Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

* * *

ARTICLE 3

ALLOCATION AND APPORTIONMENT OF BASE INCOME

35 ILCS 5/301 General Rule

(a) Residents. All items of income or deduction which were taken into account in the computation of base

income for the taxable year by a resident shall be allocated to this State.

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35 ILCS 5/601 Payment on Due Date of Return

* * *

(b)(3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act [35 ILCS 5/201] shall be credited against the tax imposed by subsections 201 (a) and (b) [35 ILCS 5/201] otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) [35 ILCS 5/201] otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. For purposes of this subsection, no compensation received by a resident which qualifies as compensation paid in this state as determined under Section 304(a)(2)(B) [35 ILCS 5/304] shall be considered income subject to tax by another state or states. The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year. Any person claiming such credit shall attach a statement in support thereof and shall notify the Director of any refund or

reductions in the amount of tax claimed as a credit hereunder all in such manner and at such time as the Department shall by regulations prescribe.

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35 ILCS 5/1501 Definitions

(a) In general. When used in this Act, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof:

* * *

(14) Nonresident. The term "nonresident" means a person who is not a resident.

* * *

(20) Resident. The term "resident" means: (A) an individual (i) who is in this State for other than a temporary or transitory purpose during the taxable year; or (ii) who is domiciled in this State but is absent from the State for a temporary or transitory purpose during the taxable year;

(B) The estate of a decedent who at his or her death was domiciled in this State;

(C) A trust created by a will of a decedent who at his death was domiciled in this State; and

(D) An irrevocable trust, the grantor of which was domiciled in this State at the time such trust became irrevocable. For purpose of this subparagraph, a trust shall be considered irrevocable to the extent that the

grantor is not treated as the owner thereof under Sections 671 through 678 of the Internal Revenue Code [26 U.S.C. § 671 through 26 U.S.C. § 678].

* * *

APPENDIX E

ILLINOIS DEPARTMENT OF REVENUE
INCOME TAX HEARINGS SECTION
CHICAGO, ILLINOIS

The Department of Revenue of the State of Illinois	)	Case Nos. 91-IT-025
	)	91-IT-066
	)	91-IT-094
	)	91-IT-095
v.	)	91-IT-279
R. A. Trusts Oregon Trusts Rainier/Washington Trust ANP Trusts Oregon/Eastside Trust F.L.P. Trusts	)	91-IT-103
	)	
	)	Admin. Law Judge
	)	Hollis D. Worm
	)	

FIRST SUPPLEMENTAL STIPULATION OF FACTS

Taxpayers, R. A. TRUSTS NOS. 1-25 (the "R. A. Trusts"), WASHINGTON TRUSTS NOS. 1-176 (the "Washington Trusts"), A.N.P. TRUSTS NOS. 1-42 (the "A.N.P. Trusts") and F.L.P. TRUSTS NOS. 10-17 and 19-21 (the "F.L.P. Trusts"), and Respondent, the Illinois Department of Revenue, by their respective counsel, hereby stipulate and agree as follows:

1. The Taxpayers in this case are collectively referred to as the "Trusts" and each is separately referred to as a "Trust." The "years in issue" with respect to each Trust are the following periods:

R. A. Trusts June 1, 1986 through May 31, 1987

Washington Trusts November 1, 1986 through December 31, 1988

A.N.P. Trusts October 1, 1986 through December 31, 1988

F.L.P. Trusts January 1, 1985 through December 31, 1985

2. During each year in issue and the preceding year, each Trust earned income from a state of the United States outside of Illinois, hereinafter referred to as the "Source State." Such income is hereinafter referred to as the "Non-Illinois Income."

3. The income tax laws of the Source State classified the Trust as a nonresident of the Source State, and required the Trust to pay tax on the Non-Illinois Income. The Non-Illinois Income would have been allocated or apportioned to the Source State if the Source State's income tax laws were identical to Article 3 of the Illinois Income Tax Act, 35 ILCS 5/101 *et seq.*

4. True and correct copies of the following federal and Illinois income tax forms are attached hereto as Group Exhibit A:

1986 Federal Form 1040 (U.S. Individual Income Tax Return) and Schedule A thereto;

1986 Federal Form 1041 (U.S. Fiduciary Income Tax Return);

1986 Form IL-1040 (Illinois Individual Income Tax Return) and Schedule CR thereto; and

1986 Form IL-1041 (Illinois Fiduciary Income & Replacement Tax Return) and Schedule CR thereto.

5. Group Exhibit A is similar in all material respects to the federal and Illinois income tax forms applicable to all other years in issue except calendar year 1988.

6. The amended Illinois income tax return filed by each Trust calculated "base income" for each year in issue by adding back to the Trust's federal taxable income the amount of tax which the Trust had paid to the Source State during the year. Each amended Illinois return then claimed an Income Tax Credit to offset the Source State Tax against the Trust's Illinois income tax liability. The Income Tax Credit claimed by the Trust contradicted the instructions to Form Il-1041, Schedule CR as in effect for all years in issue except calendar year 1988.

7. During each year in issue, all Trustees of the Trusts were individuals who were domiciled in Illinois, the administration of the Trusts occurred in Illinois, and all beneficiaries of the Trusts were individuals.

8. All of the beneficiaries of the following Trusts were domiciled outside Illinois at all times during the years in issue:

R. A. Trusts Nos. 5-8 and 13-24.

Washington Trusts Nos. 1, 5, 6, 9-12, 33, 37-40, 42-44, 47, 48, 69, 70, 82-88, 90-96, 105, 109, 110, 112, 153 and 169.

A.N.P. Trusts Nos. 6, 7B, 7C, 9, 11, 13B, 13C, 15, 17, 20, 21, 23, 26, 27 and 29.

F.L.P. Trusts Nos. 12, 16 and 17.

Each of the other Trusts had at least one beneficiary who was domiciled in Illinois at some time during the years in issue.

* * *

9. During each year in issue, each Trust earned income from Illinois sources in addition to the Non-Illinois Income described in Paragraph 3 above.

Dated: January 5, 1996

/s/ Diane M. Anderson
Diane M. Anderson
Attorney for Taxpayers

/s/ Robert Asbille
Robert Asbille
Special Assistant
Attorney General

Approved

Dated: 1/18/96

/s/ Louise M. Calvert
Louise M. Calvert
Associate Chief
Counsel

Approved:

Dated: 1/18/96

/s/ Hollis D. Worm
Hollis D. Worm
Administrative
Law Judge

STATE OF ILLINOIS)
)
COUNTY OF COOK)

AFFIDAVIT OF STEVEN D. SPECTOR

Steven D. Spector, being first duly sworn and upon oath, deposes and states as follows:

1. I am authorized to make this Affidavit; I have personal knowledge of the facts contained herein, and, if called as a witness, can competently testify thereto.

2. I am a licensed Certified Public Accountant in the State of Illinois. Since August 20, 1990, I have held the position of Vice President – Taxes with the accounting firm of Diversified Financial Management Corp. ("Diversified").

3. In my capacity as the Vice President – Taxes of Diversified, I provide tax return preparation and related services to Oregon Trusts Nos. 1-208, hereinafter collectively referred to as the "Oregon Trusts"; R. A. Trusts Nos. 1-25; Washington Trusts Nos. 1-176; A.N.P. Trusts Nos. 1-42; and F.L.P. Trusts Nos. 10-17 and 19-21. Oregon Trust No. 9 is also known as the Eastside Trust. Washington Trust No. 1 is also known as the Rainier Trust. All of the above trusts are hereinafter collectively referred to as the "Trusts" and each is separately referred to as a "Trust."

4. Exhibits 1 and 2 to this Affidavit summarize various items that appear in the Trusts' accounting books and records and federal and Illinois income tax returns, and were prepared under my supervision, direction and control.

5. Each Trust filed an original Illinois income tax return (the "Original Return") and an amended Illinois income tax return (the "Amended Return") for each tax period listed in Exhibit 1 to this Affidavit (the "year in issue"). Each such Original and Amended Return was timely filed. Certain Trusts filed other Illinois amended returns which are not relevant to the refund claims in issue.

6. Under my supervision, direction and control, an Amended Return was prepared for each Trust for each year in issue. Each Amended Return claimed a refund because it claimed a credit against the Illinois income tax, the Personal Property Replacement Income Tax ("replacement tax"), or both, for income taxes which the Trust paid to other states on income earned outside Illinois.

7. Each Amended Return claimed a credit for the Source State Tax against the Trust's Illinois income tax liability. That credit is hereinafter referred to as the "Income Tax Credit."

8. The Amended Returns filed by certain of the Trusts claimed a credit for the Source State Tax against the Trust's replacement tax liability. That credit is hereinafter referred to as the "Replacement Tax Credit."

9. Exhibit 1 to this Affidavit is a true and correct summary of the amounts of the "Income Tax Credit" and "Replacement Tax Credit" which were claimed on each Trust's Amended Return. If a Trust is entitled only to the "Income Tax Credit," the amount of such credit is listed in Exhibit 1 in the column titled "Income Tax Credit." If a Trust is also entitled to the "Replacement Tax Credit," the amount listed in Exhibit 1 in the column titled "Rep. Tax Credit" is the credit which is due in addition to the

Income Tax Credit. The amount of the actual refund due for each year in issue will be based on the amount of the tax paid for the taxable year, the amount of the credit provided by Act 201(i) [which reduces the income tax for the final replacement tax due (after credits)], and subsequent adjustments to the taxpayer's account.

10. The Department timely issued a Notice of Denial which denied the entire amount of the refund which had been claimed in each Amended Return. Each Trust timely filed a Protest and Request for Hearing in response to each such Notice of Denial.

11. Each Trust filed its Original Return for each year in issue as a resident of Illinois.

12. During each year in issue and the preceding year, each Trust earned income from a state of the United States outside of Illinois (hereinafter referred to as the "Source State"). This income is hereinafter referred to as the "Non-Illinois Income."

13. For each year in issue and the preceding year, each Trust reported and paid income tax to the Source State on the Non-Illinois Income earned there, as required by the income tax laws of the Source State. Such tax is hereinafter referred to as the "Source State Tax."

14. If each Trust were a "nonresident" of Illinois, as defined by Section 1501(a)(14) of the Illinois Income Tax Act, 35 ILCS 5/101 *et seq.* ("the Act"), the Non-Illinois Income would not be sourced to Illinois pursuant to Sections 301(c) through 308 of the Act, and would not be subject to Illinois income or replacement tax.

15. All of the refunds claimed on the Amended Returns filed by the Oregon Trusts are for Illinois income

and/or replacement tax on income that would not be sourced to or taxable by Illinois if the Oregon Trusts were nonresidents of Illinois.

16. Each Trust's Original Return was filed as a resident of Illinois. As required by Act Section 301(a), that return allocated 100 percent of the Trust's "base income" to Illinois in computing its liability (before credits) for Illinois income and replacement tax.

17. Each Trust included all of its Non-Illinois Income in the "base income" it reported to Illinois on its Illinois income tax returns for the year in issue and the preceding year. Therefore, the Trust paid Illinois income and replacement tax on the Non-Illinois Income.

18. Each Trust received a federal income tax deduction for the Source State Tax it paid during the year in issue, in accordance with Section 164 of the Internal Revenue Code.

19. The Amended Return filed by each Trust for each year in issue calculated "base income" by adding back to the Trust's federal taxable income the amount of the Source State Tax which had been paid during the year.

20. The Income Tax Credit was calculated in accordance with Act Section 601(b)(3) and satisfies all of the requirements of that provision. The Source State Tax is a tax "imposed on or measured by income" within the meaning of Act Section 601(b)(3), and was paid for the tax period for which the Amended Return was filed. The Source State Tax was paid on income (the Non-Illinois Income) which, by being included in "base income," was also subject to Subsections 201(a) and (b) of the Act (which impose the income tax). The amount of the

Income Tax Credit for each year in issue does not exceed the ratios set forth in the second sentence of Act Section 601(b)(3).

21. The Non-Illinois Income is not "compensation" as defined by Act Section 1501(a)(3).

22. The Replacement Tax Credit was calculated after the Income Tax Credit. The Replacement Tax Credit did not include any credit for any Source State Tax which was previously claimed as an Income Tax Credit. The amount of the combined Income and Replacement Tax Credit for each year in issue does not exceed the ratios set forth in the second sentence of Act Section 601(b)(3), if the references in Section 601(b)(3) to subsections 201(a) and (b) (which impose the income tax) were deleted.

23. All of the Income Tax Credits and Replacement Tax Credits were calculated in accordance with the schedules and examples contained in Exhibit 2 to this Affidavit. The specific amounts listed in the Exhibit 2 schedules are for purposes of illustration only and are based on two examples. In the first example, Trust X has claimed only an Income Tax Credit; in the second example, Trust Y has claimed both an Income Tax Credit and a Replacement Tax Credit.

Further affiant sayeth not.

/s/ Steven Spector
Steven D. Spector

STATE OF ILLINOIS)
) SS.
COUNTY OF COOK)

I, Theresa M. Bauer, a notary public in and for the county ad state aforesaid, do hereby certify that Steven D. Spector, personally known to me to be the same person whose name is subscribed to the foregoing instrument, appeared before me this day in person and acknowledged that he signed, sealed and delivered said instrument as his free and voluntary act, for the uses and purposes therein set forth.

Given under my hand and notarial seal this 17th day of January, 1995.

/s/ Theresa M. Bauer
Notary Public

My Commission Expires: 6-5-95

"OFFICIAL SEAL"
THERESA M. BAUER
NOTARY PUBLIC STATE OF ILLINOIS
MY COMMISSION EXPIRES 6/5/95

EXHIBIT 2

SCHEDULE A

CALCULATION OF ILLINOIS "BASE INCOME" BEFORE THE ADDBACK OF THE NON-ILLINOIS TAX

(SAME FOR BOTH TRUST X AND TRUST Y)

The following schedules are based on these amounts.

Federal taxable income before deduction for state income taxes [1]	$102,000
Less: Source State Tax paid during the year in issue [2]	2,000
Federal taxable income	$100,000
Illinois adjustments	-0-
Base income before addback	$100,000

NOTES:

1. Each Trust had $30,000 of Non-Illinois Income for the year in issue, in a state with a 10 percent tax rate. Thus, the Income and Replacement Tax Credits for the year in issue were based on $3,000 of Source State Tax.

2. Each Trust's Non-Illinois Income for the preceding year was $20,000 – the $2,000 of Source State Tax on that income was paid during the year in issue.

That is the amount of Source State Tax which was deducted on the Trust's federal return and then added back on the Illinois Amended Return. For example, this tax could be: (i) tax paid with the Source State tax return for the preceding year (which was filed during the year in issue), or (ii) estimated tax payments. This number is not the same as the Source State Tax reported on Schedules C and D – that tax was paid for the year in issue.

SCHEDULE B

ADDITION MODIFICATION

(SAME FOR BOTH TRUST X AND TRUST Y)

The following addition modification was made on each Trust's Amended Return to add back the Source State Tax which had been deducted in calculating the Trust's federal taxable income.

"BASE INCOME" BEFORE ADDBACK	$100,000
Plus: Source State Tax paid during the year in issue	2,000
"BASE INCOME" ON AMENDED RETURN	102,000
Exemption	1,000
"Net income" on amended return	101,000
ILLINOIS INCOME TAX BEFORE CREDITS (2.5 PERCENT) (to Schedule C)	2,525
ILLINOIS REPLACEMENT TAX BEFORE CREDITS (1.5 PERCENT) (to Schedule D)	1,515

SCHEDULE C

CALCULATION OF INCOME TAX CREDIT (SAME FOR BOTH TRUST X AND TRUST Y)

The Income Tax Credit claimed on each Trust's Amended Return was calculated as follows. The line references are from Schedule CR to Form IL-1041.

B.	Non-Illinois Income (from the income tax return which the Trust filed in the Source State)	$ 30,000
C.	Source State Tax paid for the year in issue	3,000
D.	"Base income" on amended return (from Schedule B)	102,000
E.	Illinois income tax before credits (from Schedule B)	2,525
F.	Line B divided by Line D (rounded to 5 decimal places)	.29412
G.	Line E times Line F	743
H.	FOREIGN TAX CREDIT (smaller of Lines C, E or G)	743

The amount on Line H is the "Income Tax Credit" which Trusts X and Y claimed on their Amended Return.

SCHEDULE D

CALCULATION OF REPLACEMENT TAX CREDIT (TRUST Y ONLY)

The Replacement Tax Credit claimed on each Trust's Amended Return was calculated as follows. The line references are from Schedule CR to Form IL-1041.

B.	Non-Illinois Income (from the income tax return which the Trust filed in the Source State)	$ 30,000
	Source State Tax paid for the year in issue	3,000
	Less: Income Tax Credit (from Schedule C)	743
C.	Source State Tax available for credit	2,257
D.	"Base income" on amended return (from Schedule B)	102,000
E.	Illinois replacement tax before credits (from Schedule B)	1,515
F.	Line B divided by Line D (rounded to 5 decimal places)	.29412
G.	Line E times Line F	446
H.	FOREIGN TAX CREDIT (smaller of Lines C, E or G)	446

The amount on Line H is the "Replacement Tax Credit" which Trust Y claimed on its Amended Return.

APPENDIX F

SUPREME COURT OF ILLINOIS
CLERK OF THE COURT
SUPREME COURT BUILDING
SPRINGFIELD, ILLINOIS 62701
(217) 782-2035

February 2, 2000

Ms. Diane M. Anderson
Neal, Gerber & Eisenberg
Two North LaSalle Street
Suite 2200
Chicago, IL 60602

No. 88453 – Simon Zunamon, etc., et al., petitioners, v. Kenneth E. Zehnder, Director of the Illinois Department of Revenue et al., respondents. Leave to appeal, Appellate Court, First District.

The Supreme Court today DENIED the petition for leave to appeal in the above entitled cause.

The mandate of this Court will issue to the Appellate Court on February 24, 2000.